VISION

To be the pre-eminent financial institution in Pakistan and achieve market recognition both in the quality and delivery of service as well as the range of product offering.

MISSION

To be recognized in the market place by Institutionalizing a merit & performance culture, Creating a powerful & distinctive brand identity, Achieving top-tier financial performance, and Adopting & living out our core values.

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NBP Performance at a Glance

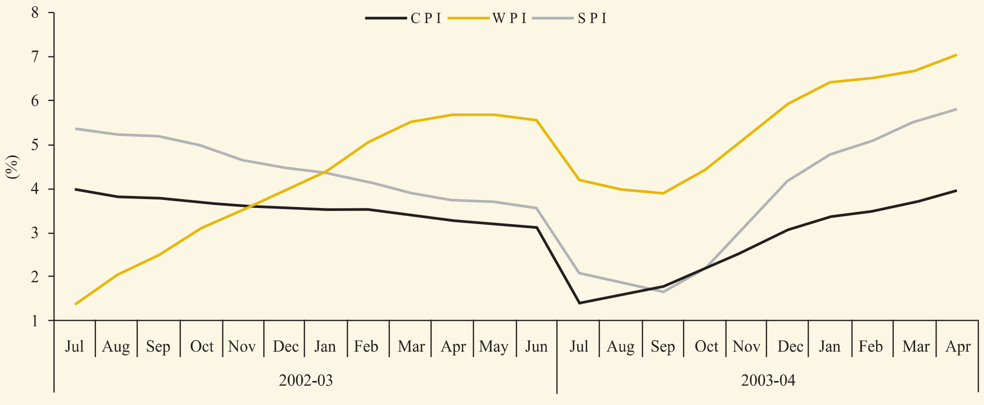
Editor's Corner

Dear readers,

In the last few years we have seen that inflation in Pakistan has remained in single digits. The inflation indices — Consumer Price Index (CPI), Wholesale Price Index (WPI), and the Sensitive Price Indicator (SPI), which provides information on prices of selected essential items reinforce this picture. It is since October 2003, that there has been a steady increase in prices. This has been confirmed through these indices which are computed and published by the Federal Bureau of Statistics.

The contributory factors responsible for the containment of inflationary pressures in the economy before October 2003, have been, among others, sufficient availability of food, strong Rupee, and the State Bank of Pakistan's (SBP) Sterilization Policy. In simpler terms, sterilization implies SBP intervention in the inter-bank forex market to purchase US dollars and neutralizing the monetary impact of the intervention, primarily through auctioning of the government paper. Each time the SBP intervenes to purchase foreign exchange, it adds to liquidity in the Rupee market, it is equally important that SBP neutralizes the impact of the intervention. As without this, the resultant increase in domestic liquidity less output expansion, would give rise to inflationary pressures.

Price Inflation Indicators



While in the early part of FY04 the pick up in inflation was the outcome of an increase in the price of some food items, the later months saw both rising prices of food items and an increase in money supply. Monetary assets (M_2) rose by 14.02% during July 03 – May 1, 04 against the target of 11.06% set in the Credit Plan for 2003-04.

Since the last six months, prices of nearly all commodities have started to increase, some more rapidly than others. Figures available from the Federal Bureau of Statistics show that during the period July-April 2004, CPI rose by 3.93% over the corresponding period of the preceding year. In the same period, the WPI has risen by 7.05% and SPI showed a rise of 5.8%. These increases are sharper for the month of April — 6%, 10.3% and 8.4% respectively over the corresponding figures for 2003.

Increase in the CPI has resulted largely from a substantial increase in the food component as prices of many food items, especially wheat flour, vegetables and meat rose. House rent which has a large weight in the group (23.43%), rose by 7% in April 2004, over the year, reflecting the recent boom in the prices of property and rising house rents.

Both food and non-food components of the WPI, witnessed acceleration in the first ten months of FY04 compared to FY03, recording increases of 5.96% and 7.94% respectively. The WPI food inflation (accounting for 42.1% of the weight in the group) alone saw a rise of 8.6% in April 04 over last year's figure as prices of maida, wheat flour, vegetables, and meat rose.

The increase in prices was much higher for WPI non-food component as there was an upward movement in all WPI sub-indices during the current period, particularly those for fuel, lighting 13.2% (19.3% weight in the group) and raw materials 9.4% (8% weight in the group). In the former category, prices of coke surged. In raw materials, cotton, mustard & rapeseed prices rose. Domestic cotton prices have risen to over Rs.3215 per tonne (ex-gin price).

The rise in prices is detrimental to all as it affects the purchasing power. Whether you have a savings account with a bank, or you are entitled to a pension you are directly affected by inflation. For millions of people every step upwards in the ladder of inflation means a further decline in the real value of what they have saved through years of toil and sacrifice. The money they will be receiving would be capable of providing less food, clothing and shelter, and at the margin may push some below the poverty line and render others chronically poor.

Ayesha Mahmud

Abstract of the Bulletin

Pakistan's Banking Sector

§ Noticeable transformation has taken place in the country's banking sector over the last decade. Privatisation of public sector banks has been on top of the government agenda. Banking laws have been strengthened, good governance has received emphasis, mergers and buyouts have taken place, separate institutions have been set up to cater to the credit requirements of micro and small enterprises and individuals, banks internal working has been revamped, e-banking has been introduced, banks lending portfolio has diversified and there is resurgence to introduce Islamic banking in the country.

§ Pakistani commercial banks operating in Pakistan have introduced new financial products and services. Earlier these were the domain of the foreign banks and certain local banks, but now more banks have entered the market.

§ All banks are laying emphasis on upgrading their IT infrastructure.

§ The Shariah Board of the State Bank of Pakistan has approved the essentials of Islamic modes of financing. These are proposed to be enforced as Prudential Regulations for Islamic banks in due course.

§ Meezan Bank was the first bank to be granted the licence of a scheduled Islamic Commercial Bank in 2002.

§ Non-Performing Loans have been a major problem afflicting banks. However, a multi-pronged strategy is being pursued to reduce the existing burden.

Pre-Budget 2004-05

§ The Federal Budget 2004-05 is expected in the first week of June.

§ While economic fundamentals have improved, the benefits have not trickled down to large segments of society as reflected by some of the key social and human development indicators.

§ The Budget is expected to focus on poverty reduction. The full Poverty Reduction Strategy Paper prepared towards the end of last year, emphasize certain areas which need to be focused upon to reduce poverty.

§ The other areas expected to receive emphasis in the Budget includes, raising of the level of investment in the economy, promoting export oriented industries especially of higher value added items, development of infrastructure etc.

Current Wheat Situation

§ In recent years, the severe drought and water crisis that the agricultural sector was faced with, has adversely affected the wheat crop.

§ The production – consumption gap is met through imports.

§ Late crushing of sugarcane in Sindh has resulted in delayed planting of the wheat crop. The province is faced with acute wheat shortage.

§ The government and the State Bank of Pakistan have taken steps to avert wheat shortfall and ensure availability and stability of wheat prices in the open market.

Market Analysis

§ The market saw heavy gains throughout March and most of April 2004, but became volatile towards the end of April and into early May. The 2004-05 Budget is now awaited, and could provide good news for some sectors. There is a threat of inflation and a slight rise in interest rates, but the overriding driver of stock prices continues to be high liquidity.

Pakistan's Banking Sector

Introduction

1990s a period of reforms

Pakistan's banking sector has experienced profound changes over the last decade. Banks, which were under government control have been partially/completely privatized, local private banks have been set up, commercial banking has diversified from traditional services to new services, such as, consumer financing, e-banking. Existing services have been revamped by introducing new schemes, keeping in view the business needs of the clientele. There is also a movement towards the adoption of Islamic banking to run in tandem with conventional banking practices.

Mergers take place

For most nationalized commercial banks, there has been a streamlining of domestic operations, with the closure of many branches and retiring of surplus staff. There has also been a process of mergers and buyouts; Societe Generale was merged into Meezan Bank, NDFC was merged with National Bank of Pakistan, Al Faysal Investment Bank with Faysal Commercial Bank among others.

Laws strength-ened

The State Bank of Pakistan has been given greater and enhanced autonomy, Prudential Regulations have been strengthened, Banking Companies Ordinance 1962, Loan Recovery Laws, State Bank of Pakistan Act have seen changes so to lend support to the reform process. The supervisory framework of State Bank now conforms with international norms. Commercial banks now have to comply with the Code of Corporate Governance, which has been issued by the Securities and Exchange Commission of Pakistan.

Poverty receives attention

Microfinance institutions have been set up to meet the credit needs of micro and small enterprises/individuals. As rising poverty is a major challenge confronting the Government, it is institutions like the Khushhali Bank, and the SME Bank which can reach out to the poor individuals, meet the credit requirements of small enterprises and help bring about a change in the lives of a vast majority. In the following pages, major developments in the banking sector have been discussed briefly.

Privatisation of Banks

Banking sector reforms initiated in the early 1990s included in its ambit privatization of state owned banks. Public sector banks were overstaffed, over branched, afflicted with huge infected loan portfolios, high operating costs, poor customer services, fewer products etc. In 1990, United Bank Limited, National Bank of Pakistan, Habib Bank Limited and Muslim Commercial Bank had a cumulative staff strength of 84300, and were operating over 6200 branches.

Public sector banks inefficient

The inefficiencies of the public sector banks had affected the overall performance of the banking sector. Classified advances made a substantial part of the banks' lending portfolios, profitability had declined, banks were not offering any new products/services to their clients, and the State Bank of Pakistan had to inject equity in certain large public sector banks to strengthen their capital base.

Reforms initiated

To make these banks competitive and to improve the financial soundness of the banking system, privatization had become inevitable. The first to be privatized was Muslim Commercial Bank in April 1991. The Government of Pakistan transferred the management of the Bank to National Group by selling 26% shares of the Bank. It also sold 25% of the paid up capital to the general public. Additional 24% shares were purchased by the Group by the end of 1992, making their holding 50%. Remaining shares were offloaded gradually and by the year 2002, all the shares held by Government of Pakistan/State Bank of Pakistan in Muslim Commercial Bank had been divested.

Similarly United Bank Limited was privatized at the end of 2002. The Government sold 51% of their shareholding to the consortium comprising of Bestway Group of UK and Abu Dhabi Group of UAE. Earlier in 1998, the State Bank of Pakistan had injected Rs.21 billion equity in the bank to strengthen its capital base. Early this year, 51% of the stock of Habib Bank Limited, the second largest commercial bank in the country in terms of assets was sold to Aga Khan Fund for Economic Development.

National Bank of Pakistan has offloaded 23.2 percent shares in the Stock Exchange.

Privatization of these large public sector banks has brought about a sea change in their performance. Their financial indicators have scaled the graph, introduction of consumer financing and leasing has added new revenue lines and diversified risk, rationalization of the branch network has been accompanied with a reduction in staff strength, technology infrastructure is being upgraded and strengthened, recovery of non performing loans has been an area of priority, best practices of corporate governance are being complied with, IT services have seen great advancement, with MNET and 1-Link operational, and human resource development has received focus by all banks. The following tables will shed light to the improved state of the two banks, Muslim Commercial Bank and United Bank Limited after privatization.

Perfor-mance improves

Muslim Commercial Bank

(Rs.Bn)

	1990	1992	2003
Deposits	27.7	50.0	211.5
Paid-up Capital	0.576	0.576	3.0
Advances	18.9	25.6	97.2
Branches	1283	1288	986
Imports handled	15.2	28.3	64.4
Exports handled	11.0	17.9	28.6
Home Remittances	1.7	2.4	41.5
Net Assets	36.3	62.4	272.3
Pre tax Profit	0.16	0.26	3.6
No. of Employees	12904	12792	10164
No. of Accounts (Mn)	2.89	3.22	4.43
		15% bonus share announced in 1992	Earnings per share was Rs.11.79. 10% bonus shares 12.5% cash dividends besides 10% final dividend in the form of bonus shares were announced in 2003.

United Bank Limited

(Rs.Bn)

	1998	2003
Net Equity	5.5*	10.3
Assets	139.5	225.4
Deposits	117.7	189.8
Advances	47.4	103.3
Profit (BT)	(4.2)	4.5
Home Remittances	4.0	20.2
Imports handled	40.2	98.9
Exports handled	29.3	45.7
No. of Branches	1494	1077
No. of Employees	14885	8815

**A year earlier there was a negative equity of Rs.18.5 billion. The SBP injected Rs.21 billion equity in May 98.*

Deepening of the Financial System

Developing countries, including Pakistan have supported liberalization of their financial system after seeing the experience of many of the rapidly growing countries, who abolished various types of controls and interventions in their financial markets. The generally more successful economic performance of Asian economies over the last two decades has underpinned and enlarged the benefits of financial sector reforms.

The results of financial liberalization have led to reduced government control over the banking system. Public sector banks have been divested, non-bank financial institutions have been set up, new private commercial banks have been set up, there is no restriction on the entry of foreign banks, interest rates are no longer administered, new financial products are services have been introduced by the commercial banks operating in Pakistan. As the priority task of the government is eradication of poverty, microfinance institutions have been established and the State Bank of Pakistan continues with its efforts at introducing Islamic banking. All these have been discussed in the following pages.

E-Banking

Since the last few decades, there is a growing list of challenges banks all over are faced with. Markets have become highly competitive and with the evolution of computers and communications technology, there is increasing volume, speed, value and complexity of financial transactions. Banks are now required to adapt to the changing world, if they are to keep their place in the market. Failure would result in new players entering the market and eating their share.

e-bank-ing in formative phase

While e-banking is a way of life in the more developed countries, in Pakistan it is still in infancy. E-banking enables financial institutions to offer their customers secure, round the clock access to electronic financial products and services anytime, anywhere. Technological methods of payments, collection have evolved and replaced traditional ones. Electronic payments have been displacing paper based products and the trend is likely to grow, as more people use debit and credit cards as their main mode of payments rather than cheques.

Today the automated teller machine (ATM) introduced over 30 years ago has become one of the most critical channels in the distribution network of a retail bank. There are over one million ATMs throughout the world, performing 40 billion transactions each year. Its basic function of cash withdrawals has not changed, though in many countries, ATM functionality is advancing rapidly. Host of services are available at ATMs, including cash dispensing, cheque cashing, bill payment, account inquiries, passbook/document printing and e-commerce. In some countries like for instance, China and India, the current trend is for increasing ATM installations instead of branch operations, as a way of furthering banks geographic reach. Many banks are offering advanced ATM functionality. For instance a bank in Spain is offering passbook updates, ticketing, bill payment, while in Japan ATMs are offering fund transfer capabilities.

ATM function-ality enhanced

In Pakistan, e-banking made a beginning in the 1990s. While credit cards had been introduced earlier, it was in the mid 1990s that foreign banks took the initiative by reintroducing them to the Pakistani mass market. This was followed by the introduction of ATM facility. The commercial banks in their endeavour towards automation have received the support of the State Bank of Pakistan and the government.

SBP/GoP support e-banking

The State Bank with the assistance of the World Bank is spending large sums for data warehousing, networking, application of software and other banking systems. It also made it mandatory for all scheduled banks to connect to presently available two ATM network switches, M NET and I-Link

The government reduced duty on the import of ATM machines by 50 percent and has significantly lowered communication charges over the last three years. Through the promulgation of Electronic Transaction Ordinance 2002, it has provided legal framework to e-banking transactions. The Ministry of Science and Technology is also working for the promotion of e-commerce and e-banking.

ATMs becoming popular

ATMs are currently becoming popular in the country and banks are expanding this facility by increasing the number of their on-line branches and installing more ATMs. During the last few years there has been a growth both, in the number of ATMs and in the number of transactions. The services offered is however, restricted to cash withdrawals, balance enquiries and statements. Banks are however, working towards expanding existing services.

Growth of ATMs

	2000	2001	2002	HI 2003
No. of online branches	322	450	777	994
No. of ATMs	206	259	399	445
No. of transactions (000)	3624	5923	9319	6450
Value of transaction (Rs.Mn)	12507	22108	37786	28052

Source: - State Bank of Pakistan

Private domestic banks are the major suppliers of ATM facility. Muslim Commercial Bank has 190 ATMs and 269 on-line branches. It also provides internet banking.

Banks like National Bank of Pakistan, Askari Commercial, Habib Bank and Bank al Falah have ambitious plans to upgrade their ATM network and take initiatives to enhance customer convenience. National Bank of Pakistan is investing in its IT sector, so that in the next few years a substantial part of its banking transactions are carried out through the electronic media.

IT being upgraded

Late 2003, consortium of banks got together to join the 1-Link ATM switch of ABN Amro. This enabled the customers of member banks of on-line branches a wide choice of ATMs. Besides 1-Link switch, another switch owned by Muslim Commercial Bank, namely, MNET is in operation connecting 13 banks ATMs throughout the country. The two ATM switches are now interconnected. ATM card or debit cardholder of any bank has now access to their accounts for cash withdrawals and balance inquiry facility through any ATM in Pakistan.

In the last decade, not only has there been a pick up in the infrastructure supporting electronic

Increased use of Credit Cards

payments but people's confidence in electronic transactions has gone up. This is reflected in the increased use of ATMs and credits cards. Credit card business is gaining popularity in Pakistan.

While credit card business is dominated by some foreign banks, local banks are showing keen interest and have entered the card market. Domestic private/privatized banks have come up with innovative schemes and are a step ahead of the government sector banks, Citibank and Standard Chartered have a large credit card clientele, as their numbers have crossed a 150 thousand each.

MCB has large credit card holders

Muslim Commercial Bank was the leading issuer of ATM/Debit cards with more than 525,000 cards. Its customers can now use the card at ATMs and points of sale terminals abroad. National Bank will soon be launching its Debit/ATM Card under the name of NBP Cash Card. This would enable users of on-line branches an access to withdraw cash from over 600 ATMs of 1-Link ATM Switch/MNET Switch with facilities of purchases from around 4000 Point of Sales (POS) terminals countrywide including 2500 POS terminals in Karachi. Some banks have issued debit cards, others have enabled their customers to manage their accounts electronically and many have started phone banking services. This goes to show that the clientele of banks is now more inclined towards the usage of modern technology.

Invest-ment to develop infrastruc-ture

Banks operating in Pakistan are investing heavily in acquiring modern technology. As services offered have become more sophisticated, banks have simultaneously paid increasing attention to develop their infrastructure. To ensure speedy payments and settlement of financial transactions, minimize risks involved, a Real Time Gross Settlement (RTGS) system has been developed, whereby settlement of inter-bank financial transactions is carried out on a continuous transaction by transaction basis throughout the processing day. There is also progress with regard to automated cheque clearing, government securities and corporate securities settlement systems.

To automate the payment system, a beginning was made to change manual cheque clearing to automation. The process is now done electronically ensuring smooth and efficient settlements.

Consumer Financing

New areas open up

Rapid expansion in consumer credits by commercial banks in recent years is a major development in Pakistan's banking sector. Consumer Finance is an institutional arrangement that provides individuals with financing support for meeting their personal, family and household needs and improving their standard of living. The instruments range from credit cards to housing/auto finance and personal loans.

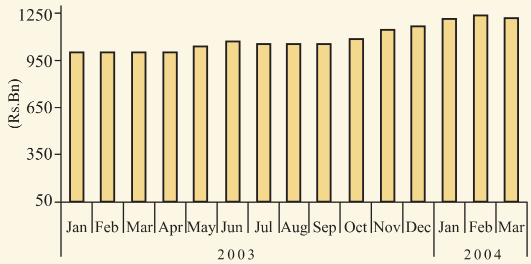
Consumer financing is a relatively new area for local commercial banks. In the past, consumer financing activities were considered to be the function of Non-Bank Financial Institutions (NBFIs). Pakistani commercial banks had completely ignored consumer financing as an activity. As a State Bank of Pakistan (SBP) policy, there was a restriction on housing and lease financing by local banks. Some banks were, however, undertaking these activities through separate subsidiaries, especially set up for this purpose.

In early 1990s, few banks started to offer credit cards to a selected clientele. They availed the facility as a mode for payment of utility bills, while traveling abroad, and not as financial support for meeting personal needs. Citibank pioneered the development of consumer banking in 1993, by offering a comprehensive range of credit cards, auto mobile loans and individual's mortgage financing. ANZ Grindlays and Standard Chartered followed suit.

Local banks show interest

As a result of banking sector reforms of 1997, the emerging concept of universal banking and increasing competition amongst banks, the need to develop consumer financing products was emphasized by banks. Initially local commercial banks were reluctant to undertake this activity due to lack of sufficient legal cover. The nationalized commercial banks in particular, were not keen to undertake consumer financing and mainly contended with extension of credit for working capital and investing in government securities that were offering high rate of returns. Privatised banks as well as newly set up private commercial banks were predominantly involved in various forms of concessionary lending.

Advances of Scheduled Banks



Focusing on consumer finance

With the changing market complexion after the 9/11 events, commercial banks in Pakistan were faced with a depressed investment climate and reduced borrowings by industrial and commercial sectors. At the sametime, the State Bank of Pakistan, as a policy measure was pursuing an easy monetary policy, interest rates had declined which also caused returns on government securities to fall. All these factors resulted in excess liquidity with the banks. Consequently most of the banks diversified their lending portfolios, and consumer financing was one area where banks started to show greater interest. A number of banks entered into negotiations with local vendors of consumer durables for the promotion of consumer banking.

Banks diversify loan portfolio

Since 2001 Pakistani banks have begun to focus strongly on consumer lending. According to the State Bank of Pakistan's Annual Report 2002-03, consumer loans rose nearly six and a half fold to Rs.45.1 billion by mid June'03 against Rs.6.1 billion in June'00. From auto/home finance to the financing of consumer durables and personal loans, local banks have become competitively aggressive in the promotion of consumer finance. More and more banks are offering consumer finance under credit cards, balance transfer facility, smart installment plan and extended payment programme (loans for consumer durables), personal loans, auto loans and home finance at competitive terms and conditions to attract customers.

Consumer Lending

(Rs.Bn)

Description	December 2003	January 2004	February 2004	March 2004
A. Bank Employees	35.56	34.76	36.09	37.21
i) House Building	23.98	23.82	24.61	25.65
ii) Transport				
i.e. Purchase of car etc.	7.68	7.81	8.42	8.0
iii) Other Purposes	3.87	3.12	3.06	3.56
B. Consumer Financing	95.37	101.52	105.53	104.79
i) House Building	4.43	5.07	4.92	5.40
ii) Transport				
i.e. Purchase of car etc.	19.22	17.98	20.27	22.02
iii) Credit Cards	9.91	10.18	10.49	10.78
iv) Consumer Durables	1.58	1.36	1.35	2.03
v) Personal Loans	39.29	42.04	45.18	46.24
vi) Other	20.94	24.88	23.33	18.30
Total (A+B)	130.92	136.28	141.62	142.00

Source: State Bank of Pakistan

Provisional figures for the first nine months of FY04 further reveals an unprecedented growth in banks' credit to private sector on account of lower interest rates and increased demand for consumer financing. Credit extended totaled Rs.105 billion (Rs.142 billion if loans to bank employees are included), reflecting more than 100% growth in March'04 over June'03. However, consumer finance still represents a fairly small segment of the entire banking sector's credit (less than 10%).

Competitive loan package

A further analysis of consumer lending by Pakistani banks reveals that personal loans make up for nearly 45% of consumer finance. These have shown a 20% growth in March'04 over December'03. Banks were allowed to provide loans, without any collateral upto Rs.0.1 million and Rs.0.3 million (in case of credit cards), that facilitated higher disbursements under personal loans in FY03. However, in the first nine months of FY04 more personal loans have been distributed without credit card facility. Consumer financing through credit cards (above10% of the total) increased by 9% during this period.

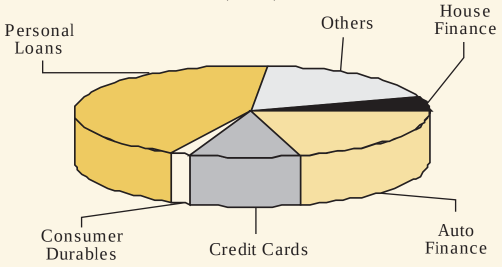
Consumer durables

Auto loans have also shown a significant growth of 16% with its share in total consumer financing (above 20%) being the second largest. Substantial auto financing in FY03, has been instrumental in the massive growth of auto industry. Home finance that was launched by most banks in late FY03, contributed to the boom in construction industry. Home loans registered the highest growth of nearly 42% in March 04, over June 03, but its share in total consumer lending is little over 5%. Consumer durables financing benefits lower middle class. Though it has posted the second highest growth (over 29%) in March'04 over December'03, its share in total consumer financing is only 2%. This is despite the fact that demand for consumer durables credit amongst lower middle class families is very high.

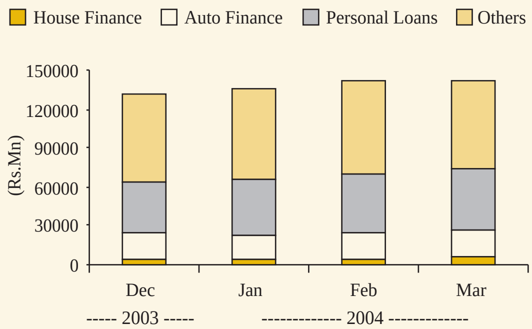
Composition of Consumer Finance

March 04

(In %)



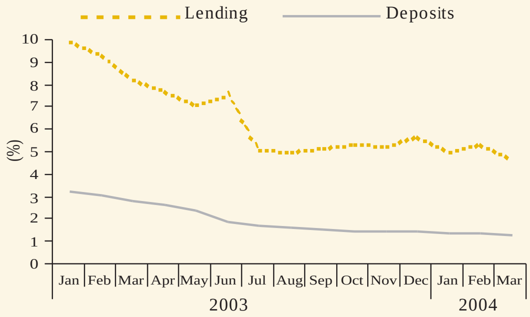
Trend in Consumer Financing



Some banks keen to diversify

In the changing market environment financial institutions like, Muslim Commercial Bank, Habib Bank, National Bank of Pakistan, Askari Commercial, Bank Al-Falah, Union Bank, Standard Chartered, Citibank, ABN Amro and some newly emerging banks in the private sector like Prime Bank, PICIC Commercial, Saudi Pak and Cres Bank are aggressively promoting consumer finance by offering attractive loan packages. Since the annual average lending rates have come down significantly and are currently at historic lows, most banks now prefer to actively undertake consumer financing. The big attraction for them is the prospect of earning high interest spread, despite declining mark up/service charges on various consumer products. Many of these banks are for the first time, focusing on consumer lending and fiercely competing for retail business.

Lending and Deposit Rates



Strong competition

Pakistani commercial banks are gearing up to acquire the best information technology and making inroads into the consumer finance business. At the sametime, privatized banks as well as other private banks are also actively pursuing personal loans for individuals. These financial institutions have emerged as strong competitors to foreign banks. Consequently, foreign banks in Pakistan are gradually losing their market share. Foreign banks which used to control 20% of total advances will find their market base getting smaller as local banks become more efficient.

The future of consumer banking in Pakistan appears bright with an increasing number of financial institutions launching new, more innovative products and services to cater to the changing financial needs of consumers. However, at present, consumer financing schemes offered by different banks mostly cover big cities in urban areas, while most of the clients are corporate employees, professionals and high worth individuals. In order to increase the market size, there is a need for extension of schemes to small towns also.

At the sametime, markup/service fee being charged on various consumer products by most banks is very high. Many banks are providing funds under credit cards, balance transfer facility, personal loans, smart installment plans and for consumer durables on mark-up/service charge ranging between 11% to 36% per annum. Even loans for housing and auto under the consumer finance package are being charged by banks at significantly higher mark up compared to average lending rates currently prevailing in the market. There is a need to reduce the mark up rates further. The growth in market size and better arrangements with vendors and manufacturers under co-branding agreement can effectively reduce mark up rates.

Islamic Banking

Shariah Board of SBP approves essentials for Islamic modes of financing

There has been a resurgence of interest in introducing Islamic Banking in the country. In a bid to comply with the verdict of Shariah Appellate Bench of 1999, the State Bank of Pakistan has put in place a regulatory framework within which Islamic commercial banks would operate. The Shariah Board of the State Bank has approved the essentials for Islamic modes of financing to ensure compliance with minimum Shariah standards by banks conducting Islamic banking. These would serve as general guidelines to be followed by banking institutions conducting Islamic banking in the country.

Further, the State Bank proposes to encourage conventional banks to commence Islamic banking operations, help them develop the market of Islamic banking products and services by providing an enabling/supporting environment, formulating specially designed Prudential Regulations, developing standardized products and services among other measures. A full fledged Islamic Banking Department has now been created in the State Bank.

In November 2002, the Banking Companies Ordinance 1962 was amended to implement the process of Islamisation of the financial system in parallel with conventional banking.

Islamic banking is gaining recognition the world over. Not only have new Islamic banks been set up, but conventional banks are opening subsidiaries and have earmarked branches or opened new branches specifically dealing with Islamic banking. Presently around 42 countries have Islamic banking institutions; 27 muslim countries and 15 non-muslim countries. They are offering specialised products conforming with Shariah to their clients and all their activities/transactions are free from interest.

With the State Bank of Pakistan committed towards the implementation of Islamic banking, commercial banks operating in the country are also showing an interest in this area. Some of the Banks through designated branches are now offering Islamic financial services to clients in parallel with conventional banking.

Meezan Bank setup

Meezan Bank was the first bank to be granted the licence of a scheduled Islamic commercial bank in January 2002. Through its 10 domestic branches it is promoting Islamic finance in the country. It is the only institution solely offering Shariah compliant avenues. Its Car Ijarah (leasing) scheme, and housing scheme based on the Diminishing Musharakah mode are totally Shariah compliant facilities.

Other banks setup Islamic banking branches

The State Bank has granted licences to Muslim Commercial Bank, Bank of Khyber and Bank Al-Falah to open dedicated branches that offer Islamic banking products to customers, while some banks have been given licences for stand alone branches. In the year 2003, 5 Islamic banking branches were added to the Bank Al-Falah network, while in the case of Muslim Commercial Bank, an Islamic banking branch commenced operations in Karachi – offering Shariah compatible products – Ijarah products, Murabahah, deposit schemes as Al-Makhraj Saving Account, Inanat Account etc. These three banks have requested for additional branches for the year 2004. Standard Chartered & Grindlays and Hongkong & Shanghai Banking Corporation and KASB Bank have expressed interest for stand alone branches.

Meezan Bank has introduced Islamic Export Refinance Scheme, developed in close coordination with the State Bank. Exporters can now avail financing at concessional rates under a Shariah compliant scheme. In 2003, Islamic Export Refinance Scheme Part-II was developed.

As has been pointed out by Dr. Ishrat Husain, Governor State Bank of Pakistan, that there are certain factors which need consideration for the growth of the Islamic finance sector. These are (i) safeguard and maximize the interest of major stakeholders (ii) provide adequate legal framework (iii) provide accounting, auditing, taxation and information support system (iv) product innovation and development should be attractive and Shariah compliant (iv) human skill development is essential and inculcation of Islamic values of integrity, ethics, truthfulness be practiced.

Small and Micro Lending Institutions

As the formal financial institutions could not adequately meet the credit requirements of micro and small enterprises, separate institutions were set up to see to their needs. While the SME Bank complements the commercial banks' lending to medium enterprises, Khushhali Bank and First Micro Bank have been set up with the objective of providing micro loans to poor persons, so to help in poverty alleviation. Commercial banks with surplus liquidity at their disposal are promoting lending to the small and medium enterprises.

The SME Bank doubled the number of SMEs financed in 2003, while disbursements showed a 75% increase.

	2003	2002
Disbursement (Rs.Mn)	1357	775
SMEs financed	2610	1008
Average Loan Size	Rs.0.6 million	
Average tenure	3 years	

The Khushhali Bank provides micro credits, finances for small infrastructure projects and skill enhancement trainings. The major contributory factors for poverty in Pakistan, include among others, the inaccessibility of capital and increase in unemployment. The government's effort in the last few years has been directed towards micro finance, public works programme and rural development as a means to provide job opportunities and improve the lives of the vast majority who live in poverty.

Khushhali Bank's lending

For rural development, the Khushhali Bank had lent as of April 30, 2004, Rs.868 million for livestock farming, Rs.804 million for agricultural development, Rs.631 million for small enterprises and nearly Rs.22 million to the other sectors. Its coverage has now increased to 40 districts, with the number of clientele rising to 101.8 thousand. Loans as small as Rs.10,000 are given and so far the bank has disbursed Rs.2.32 billion. The aim is to benefit the poor through income generation schemes. However, given its high service charge of 20%, how many of the poor will be able to afford this rate is a moot question.

While the Grameen Bank of Bangladesh has attracted international interest and is an example of a successful, equitable and sustainable development initiative, the Khushhali Bank of Pakistan has to learn a lot from their experience. Only if the Khushhali Bank is able to reach and cater to the needs of the poor, primarily women, can it ameliorate the lot of the poverty stricken people, otherwise it would have lost the basic purpose for which it was established.

Strengthening of Prudential Regulations

There is growing interest in improving financial sector regulation and supervision. The basic objective is to protect the stability of the financial system by implementing reforms to strengthen prudential systems. In developing countries, prudential reforms are usually based on upgrading banking laws, for instance by bringing minimum capital requirements in line with Basle Accord and strengthening the supervisory capacities of regulatory agencies.

The nationalisation era had resulted in a deterioration of governance and credit discipline leading to a worsening of the level of non-performing loans. Certain weaknesses in critical areas which undermined bank regulation had to be rectified and further improved as banks and non-bank financial institutions engage in more sophisticated financial activities.

The State Bank of Pakistan has established prudential regulations that act as the ground rules and guidelines for the financial industry. These mostly pertain to capital adequacy, quality of assets, management, classification and provisioning for loans, risk concentration etc. Banks and development financial institutions are expected to operate within this framework and conduct their business in a safe and sound manner, taking into account the risks associated with their activities. It is the State Bank's intention to help develop the banks' internal capacity. Separate sets of prudential regulations have been issued for Corporate/Commercial Bank, SME Financing, Microfinance Banks/Institutions, and Consumer Financing. Earlier banks were applying the same single set of rules for all these sectors.

Loan Recovery Process Strengthened

National-isation became necessary

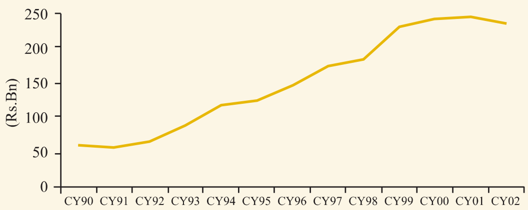
In 1974, the Banks Nationalization Ordinance was promulgated and 14 banks were taken over by the government. Subsequently 13 nationalised banks were amalgamated into 5. The primary objective of nationalization was to bring about an equitable distribution of credit amongst the different segments of the economy. Concentration of credit to a small class of big borrowers had led to maldistribution and social economic problems in the economy. Also, while borrowers were charged high rates of interest, adequate returns were not offered to the depositors. The large spread between lending and deposit rates were not used for strengthening bank's capital structure, but utilized for wasteful expenditure.

Problems in the banking sector

Nationalization however, proved no panacea for the many ills besetting the banking system. With the banking sector in government hands, it was open to political pressure and to misuse. Loans were made under political duress, with disregard to conventional standards. Classified advances of the banks grew in relation to the total loan portfolio, for some to as high as 37%. Service standards deteriorated, there was growing inefficiency in the sector, large scale overstaffing, union activity and many branches were opened with total disregard to the deposit potential of the area.

The book, History of the State Bank of Pakistan volume-III (1977-1988), states, "apart from deterioration in services, intermediation cost rose significantly particularly because of overstaffing and inefficiency. The bank lending on political basis and on considerations other than merit emerged and grew in a visible manner. As a result, there was abnormal rise in non-performing loans (NPLs) because of non-merit based lending, lack of recovery effort and legal impediments to recovery. The proportion of this problem surfaced later when the size of non-performing loans came to light."

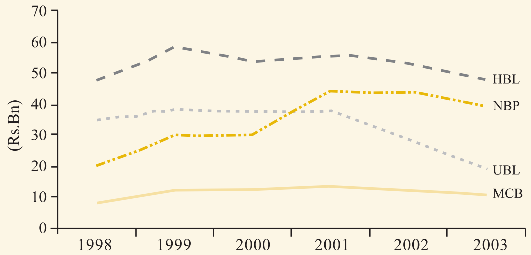
Size of NPLs



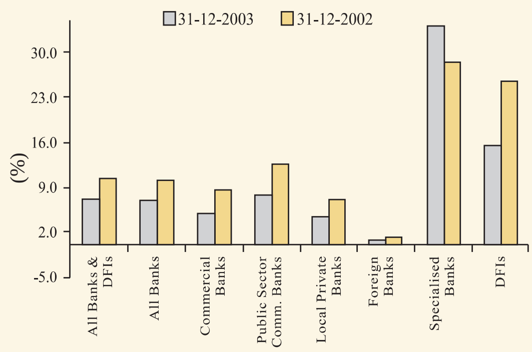
NCBs have large NPLs

This legacy that the banks inherited continues to haunt them. Over the years, rising non-performing loans and defaulted loans have resulted in increased intermediation costs for the banks. This is because infected loans not only constrain the earning opportunities, but resulting provisioning also increase the operating expenses. Nationalised Commercial Banks (NCBs) share around 50% of the total NPLs of the banking sector, primarily because substantial loans were provided by NCBs on political grounds. The size of public sector NPLs has been substantially higher over the local private banks. Amongst the public sector banks, Habib Bank has the highest NPLs. The increase in NPLs of National Bank of Pakistan during 2001 was due to NPLs of a sum of Rs.13.64 billion of former National Development Finance Corporation acquired by the bank after its amalgamation. However, net NPLs as a proportion to net loans has been quite high for specialized banks and development financial institutions.

Non Performing Advances by Banks



Net NPLs to Net Loans



Despite a number of measures initiated by the State Bank of Pakistan towards recovery of loans, "the banks have not been able to clean their balance sheets, mainly due to poor quality of underlying collateral and possible legal complications due to lacunas in the respective judicial framework", states the Annual Report 2001-02, State Bank of Pakistan.

CIRC takes up NPLs

Given the magnitude of defaulted loans, and its affect on the financial health of the institutions, the banking companies Loan Recovery Law has been strengthened to facilitate the process of mortgage, foreclosure and expeditious settlement of banking disputes. A Corporate and Industrial Restructuring Corporation (CIRC) under the Ministry of Finance has been established, whose basic purpose is to clean out the balance sheet of nationalized commercial banks and financial institutions and to prepare them for privatization. CIRC takes over the non-performing loan portfolios of nationalized banks on certain agreed terms and conditions and issues government guaranteed bonds earning market rates of return.

So far, 738 cases of NPLs of an outstanding amount of Rs.132.1 billion have been referred to the CIRC. Of these, it has acquired 234 NPLs (Rs.46.7 billion); 97 NPLs have been disposed off by CIRC involving a sum of Rs.17.4 billion. 158 accounts (outstanding amount Rs.28.2 billion) have been resolved by banks through active participation of CIRC.

CIRC has in the past three years been able to considerably reduce the stock of NPLs of the banks. The banks' efforts at clearing their stock of irrecoverable NPLs has been complemented by revised guidelines, instructions issued by the State Bank of Pakistan. The intention is to strengthen the balance sheets of the banks and to eliminate the impact of the NPLs on the lending rate. Reduction in the NPLs of United Bank Limited and Habib Bank was due to the transfer of NPLs to CIRC.

Measures adopted to check NPLs

A multipronged strategy has been adopted to check the burden of NPLs on the financial institutions. This includes besides the establishment of CIRC; referring of cases to National Accountability Bureau, particularly of willful defaulters; the setting up of the Committee for Revival of Sick Industrial Units; acceleration of the recovery process and authorization to the Board of Directors to write off loans in a transparent manner.

Growth of NPLs checked

These measures have helped to some extent check the rising NPLs and their adverse consequences on the banking sector. They were depriving the institutions of their earning assets and also pulling down their profitability. Banks had also become hesitant in fresh loaning, apprehending new additions to their already bad portfolios.

It maybe mentioned that in the graph given above, one notices, the substantial rise of NPLs in 1999. This was mainly attributed to the adoption of a vigorous standard of loan classification and its enforcement by the State Bank.

The major chunk of NPLs of the banking sector are in the loss category. Such loans have poor chances of being recovered and if banks continue to carry them on their balance sheets it would be a source of problem for the banks. For the purpose of restructuring, the banks have been provided with guidelines to settle such cases and recover outstanding dues. Banks and borrowers have benefited from the scheme, as part of NPLs have been turned into performing loans and borrowers have received a partial waiver in their outstanding liability.

Conclusion

These have been some of the major developments that have taken place in the domestic banking sector. Financial liberalisation measures have led to financial deepening and to considerable improved access to credit for previously excluded borrowers. Micro finance institutions have been promoted as a means of directly linking finance and poverty reduction. It is hoped that it would complement the government's pro-poor policies. Commercial banks housing finance can help in this regard if it provides credit to clients in poorer areas and those belonging to the middle/low income category.

Research has shown the effective role of financial regulation and supervision policy. It has a significant impact on the stability and performance of the financial sector. As banks constitute the entire financial sector, a strong banking system is therefore, the sine qua non for a robust financial sector.

Pre-Budget 2004-05

With few more days to go before the Federal Budget 2004-05 is announced, there are speculations on what the Budget may have in store for all of us. Proposals have been sent to the Finance Ministry by the various trade bodies, Federation of Pakistan Chambers of Commerce & Industry, other Chambers of Commerce & Industry. These will be vetted, fine tuned and selected ones incorporated in the Budget. Fresh incentives are expected from the Finance Minister for export oriented industries to sharpen their competitive edge; reduced tax rates and any lowering in the cost of utilities if announced would help raise the level of investment in the economy; amicable settlement of the issue of distribution of resource between the provinces, would help them undertake their provincial programmes, strengthening of pro-poor policies would bring about a change in the living standard for the vast majority.

Given the lower debt servicing and the privatisation of certain public sector organizations the burden on the federal budget has been reduced. The resulting fiscal leeway would allow the government to spend more on development projects and enhance social sector spending. Neglect of human needs, such as health, education, drinking water, rising population has resulted in pathetic living conditions for large numbers.

Economic fund-amentals improve

Economic indicators have improved, as we see a higher GDP growth, a current account surplus, foreign exchange reserves touching new highs, overall fiscal deficit declining, rising exports, doubling of worker remittances, pickup in the growth of large scale manufacturing which was most pronounced for automobiles, electronics, textiles and sugar. Inflation has remained low and interest rates have fallen. Private sector demand for credit has picked up reflecting the strengthening of economic recovery. Investors have shown interest in the stock market, due among other factors, to low deposit rates, and higher worker remittances. This has also resulted in a rise in share prices.

Exports have risen to $11.0 billion as the European Union, Pakistan's largest trading partner accounting for 21% of total trade, granted it a comprehensive package of trade preferences; and improved competitiveness of domestic textile industry and availability of export finance at lower rates helped boost exports.

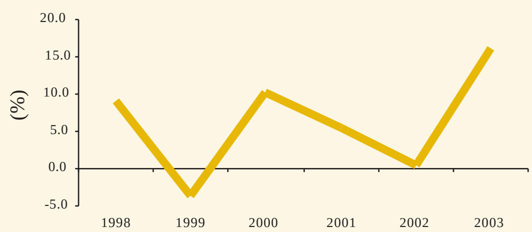
Process of privatisation has picked up and there has been an increased use of the stock market for offloading government shares, thus adding to the deepening of the stock market.

The fiscal balance has improved, as there has been a containment of expenditure and an increase in revenues. With a recovery in the domestic economy and an increase in imports, fiscal deficit is likely to meet the target for the year. In the first nine months of FY04 (July-March) tax collections had achieved nearly 70% of the target of the year. CBR tax collections amounted to Rs.353.4 billion against the full year's target of Rs.510.0 billion. The Debt Management Policy adopted three years back has led to a reduction in the size of government debt. If the government continues to pursue sound macroeconomic policies and with more resources at its disposal, it should be able to raise the level of investment in the economy to achieve higher growth.

Invest-ment needed

The government's positive economic and international political policies pursued during the last few years have yielded good results. It however, needs more investment to consolidate the economic stability achieved so far. Investment to GDP ratio in Pakistan at 15% is quite low to some other countries in the region. Last year, total investment grew by 16.2%, which is the strongest rise in the last 6 years.

Total Investment
Growth Rates



Private fixed investment rises

Real fixed investment has risen where the major impetus has come from the private sector, indicating a revival of investor confidence. The increase in investment is largely attributable to higher investment in large scale manufacturing, construction, transport and communication.

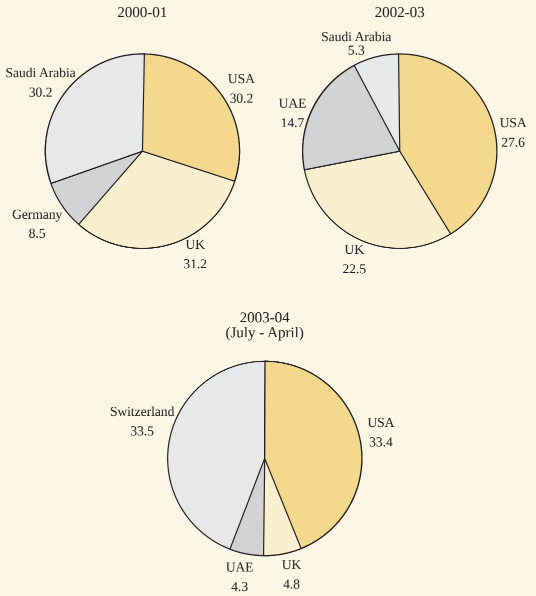
More investment can only be forthcoming if investor confidence is further boosted. This is a function of a number of factors, which include among others, political stability in the country, costs of production, law & order, tax, tariff, exchange regimes etc.

Some indicators point towards an improvement of investor confidence. There has been a rise in project financing, in the flow of foreign direct investment and an increase in the domestic production of capital goods.

Improved relations with India is expected to enhance the investment climate and give a boost to economic activity. The signing of the South Asian Free Trade Agreement by the members of the SAARC has also improved the economic prospects. It would see a reduction of tariffs between member nations and would lead to expansion of intra-regional trade for the benefit of the region.

Composition of Foreign Private Investment

%



Net inflow of foreign private investment has increased during the last 3 years. The quantum of inflows has jumped from $182 million in FY01 to $820 million in FY03. The composition of inflows shows that the US has been the largest investor of private investment in Pakistan. In FY04, the share of UK and the UAE declined, while direct investment from Switzerland showed a significant rise.

The Federal Budget is expected to provide the base for a rise in real level of investment in the country. A consistency in the current economic policies, accompanied with more incentive to attract industrial investment in the country would help in the development of socio economic projects.

New trade regime

A strong industrial base is needed in the post 2005 scenario. The forthcoming Federal Budget is expected to give due consideration to the genuine demands of the businessmen, especially with regard to high cost of utilities, the tax refund system, the development of infrastructure etc. Private sector will be called upon to play a greater role to meet the challenges of the new trade regime. The deregulation and privatisation programme of the Government in recent years shows that it has assigned a greater role to the private sector. In FY03, real private fixed investment rose by 16%, marking the first double digit growth for any year over the past decade. Real fixed investment in public sector rose by only 1.3%, focused on large scale manufacturing, transport and communication.

Under the new trade regime of the WTO, the standards set by importing countries would require certification of our export merchandise. The PCSIR plans to facilitate and help the local industry in meeting the increasing requirements of standardisation in importing countries of products produced in Pakistan. The Federal Budget is expected to provide incentives to assist local industry upgrade its machinery and processes, like lower duty on import of machinery, lower taxes on the import of raw materials. Special emphasis is expected to be placed on the textile sector, for in the era of value addition, Pakistani textile manufactures must go for export of higher value added items, otherwise they will not be able to compete internationally.

Box Snapshot of Business Environment - Pakistan

A World Bank paper 'Snapshot of Business Environment – Pakistan' has shown through various indicators the ease or difficulty of doing business in Pakistan. It has identified specific regulations and policies that encourage or discourage investment, productivity and growth. We reproduce below excerpts from the paper.

	Pakistan	Regional Average
Starting a Business	*(challenges of launching a business in Pakistan)*	
No. of procedures required to establish a business	11	8
Associated time (days)	24	43
Cost (% GNI per capita)	36	52.5
Hiring & Firing Workers (2003)	*(flexibility or rigidity of labour regulations and laws in Pakistan)*	
Flexibility of Hiring Index	65	39
Flexibility of Firing Index	33	39
Conditions of Employment Index	75	68
(Higher value represents more rigid regulations)		
Enforcing Contracts	*(ease or difficulty of enforcing commercial contracts)*	
No. of procedures	30	21
Duration (days)	365	358
Cost (% GNI per capita)	45.8	92.6
Getting Credit	*(measures on getting credit in Pakistan)*	
Public Credit Registry Index (covers credit information coverage, distribution, access and quality for public registries)	42	46
(Higher value indicates that rules are better designed to support credit transactions)		

There is a need to make the businessmen aware of the issues involved in the implementation of WTO regime in 2005. The environmental issues have to be addressed, like for instance the environmental problems being faced by Hattar Industrial Estate, Haripur. The waste from leather tanneries is hazardous and effluent treatment plants are needed. The Government has approved the Guidelines for Determination of Pollution Charge for Industry. It needs to integrate environmental concerns into the development process.

Distribution of resouces - a contentious issue

While the Government has increased the province's share in federal divisible pool from 46% to 47%, the provinces are insisting on a 50% share. Inspite of a number of meetings, the issue has not yet been resolved. The more recent NFC meeting under the chairmanship of the Prime Minister, to bring about a reconciliation between the two sides remained inconclusive. The federal government has however, enhanced its offer of 47% share to 47.4%.

It seems the provinces will have to base their budgets on the previous awards. There is also a contention between the provinces on the distribution formula. Should the criteria be based solely on population, or include income generation, and backwardness?

Poverty reduction remains one of the critical challenges Pakistan is faced with. Estimates of

Poverty - a challenge for the planners

poverty vary from 30-40% of the population or nearly 40 million people are living in a state of poverty. The Interim Poverty Reduction Strategy Paper adopted by the government in 2001 has been finalized. The strategy adopted to reduce poverty seeks to accelerate human development, improve governance with emphasis on promoting sustainable and broad based growth.

PRSP finalized

The strategy proposed in the PRSP has a strong emphasis on creation of more jobs. As such sectors like agriculture, small and medium enterprises, housing and construction, which have a potential to create jobs have been focused upon. Areas that have been strengthened compared with the interim paper, are employment, gender and the nexus of environment with poverty. It also includes a more focused human development strategy.

Public expenditure in these sectors is expected to be raised from 5.2% of GDP in FY03 to 6.0% in FY06. The World Bank/IMF in its assessment of the Poverty Reduction Strategy Paper says, "although these allocations underscore the government's resolve to provide additional resources for poverty alleviation, many improvements will be required in budget execution and financial accountability procedures and practices to translate these allocations into effective expenditures".

The Report, 'Human Development in South Asia 2003', has talked about some of the policy imperatives that are critical in making employment the main vehicle for equitable and sustainable economic growth with commensurate poverty reduction. The challenge is to develop policies and strategies that would make employment generation an explicit concern and outcome of the economic development process …..... more active state interventions in supporting labour intensive growth patterns. There is a need for a comprehensive macroeconomic, trade and social development framework that recognises the crucial role of governments in promoting pro-poor economic growth and job creating infrastructure development.

The Budget for FY2004-05 is expected to enhance poverty related expenditure. This would include focus on rural areas, where there is wide scale under-employment and unpaid family labour. Rural development could be achieved through improving agricultural productivity, protecting the small farmers etc; promoting small & medium enterprises; micro credit initiatives; community infrastructure among others. Expenditure on social sector needs to be enhanced and if the need arises for any cuts in expenditure it should be the non-development expenditure.

Current Wheat Situation

Over the years, a significant increase in wheat production has been achieved by the growers. A record crop of over 21 million tonnes was harvested in 1999-00, which was above the consumption requirement and led to an exportable surplus the following year. Large crop is attributable to increased usage of fertilizers, improved varieties of high quality wheat seeds, better water management and adoption of modern farming techniques. Production has since declined and has averaged 18.8 million tonnes during the three years ended FY03. Output declined due to water crisis and drought conditions in the past two years.

While the current season's planting was delayed due to heavy rains towards the end of last year, greater availability of inputs and government efforts induced farmers to bring larger area under the crop. Overall, about 8.2 million hectares have been brought under wheat cultivation, slightly higher over the previous season, due to greater availability of irrigation water as a result of widespread rains. Punjab and NWFP reported an increase of 3% and 9.4% respectively in area sown, while in Sindh and Balochistan it has fallen by 25% and 55% respectively, mainly caused by delayed sowing due to late commissioning of sugarcane crushing.

Crop size varies

The latest assessment of the wheat crop by the Federal Committee on Agriculture place production tentatively at 20.1 million tonnes, with Punjab and Sindh attaining 16.4 and 2.2 million tonnes respectively and NWFP and Balochistan producing 1.4 million tonnes. However, private sector estimates a smaller crop of 19.7 million tonnes. As against this, the country's current needs for wheat are at around 20-21 million tonnes required to feed the growing population.

Plantation delayed

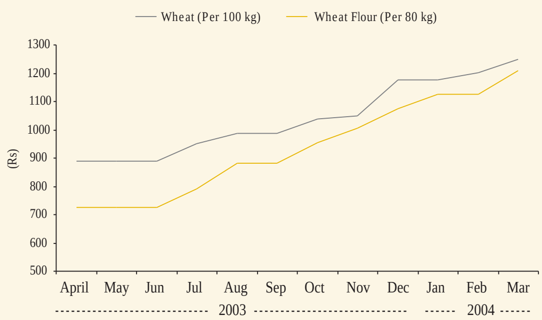
Anticipating a shortfall in production, due to delay in plantation and smaller than expected stock level, the government had earlier ordered import of 0.15 million tonnes of wheat from Australia. This was later rejected due to the presence of some virus i.e. karnal bunt. At the same time, there were reports of slow pace of procurement. The Punjab government, in order to meet its procurement target of 3.5 million tonnes, banned inter-provincial and inter-district movement of wheat. Though the government had increased procurement prices by 17% to Rs.8750 per tonne, wheat prices in the open market were around 30% higher than the official prices and there were reports of wheat flour shortages in many parts of the country.

Flour prices rise

In Sindh, where wheat plantation was delayed and growers have harvested a smaller sized crop, wheat procurement is well behind the target. Ban on inter-provincial movement has further aggravated the situation and shortages have arisen. Due to non-availability of wheat, many flour mills have shut down their operation and flour prices have also shot up. The Sindh Food Department has procured only 0.17 million tonnes, or 28% of the target, with reports of wheat being smuggled to neighbouring countries.

The government, in order to curb cross border movement and smuggling, has already banned wheat export. At the same time, it has decided to import one million tonnes of wheat to maintain buffer stocks to avert any possible shortfall in local supplies. Increase in wheat import is also likely to increase carryover stocks next year. Yet in another step, the State Bank of Pakistan has also imposed a cash margin of 50% on bank loans granted to the private sector for the procurement of wheat. The decision has been taken with a view to discourage wheat hoarding by reducing the private sector participation in wheat business. The step will also ensure stability in prices of flour and wheat and their continued availability in the market.

Wholesale Prices

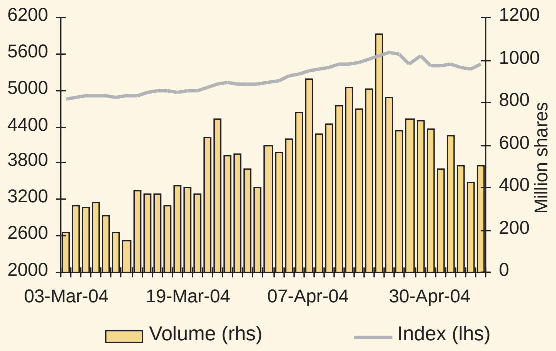


Market Analysis

Market Review

The market saw heavy gains throughout March and most of April 2004, but became volatile towards the end of April and into early May. The KSE-100 Index rose 266 points in March and then another 514 points till mid-April when it reached a high of 5620 points before falling 190 points to close April at 5431. April saw very heavy trading volumes too, with a record of 1.1b shares traded in a single day on April 16, 2004. The average daily shares traded of 707m shares were high during the month. The market was becoming over extended, especially in high momentum stocks (NBP, SNGPL, OGDCL, the cement sector), and the daily strong gains, rising badla volumes, and heavy trading made the technical pullback inevitable.

KSE-100



Top performers

Top performers over the March-April 2004 period were Lucky Cement, Nishat Mills, DG Khan Cement and OGDCL. Dewan Motors, Hubco, PIA and PSO were the main under performers. Quarterly earnings announced towards the end of April were mixed. The fertilizer sector reported growth, as did PTCL, SNGPL, SSGC and NBP. The auto sector gave very disappointing results, as did PIA, Unilever, the OMCs (Shell and PSO), and some banks (notably MCB). Even the cement sector showed a quarter-on-quarter decline as demand growth slowed in the winter months, though this is now expected to improve.

Looking Ahead

In many cases, the steep share price appreciation means that finding value is becoming increasingly difficult.

Sectors to watch out for

Even so, looking ahead there is still tremendous liquidity driving share prices and we expect upward momentum to continue. The 2004-05 budget will be announced in June and we expect pre-budget speculation to bring up the market. It is believed the upcoming budget will be investment focused. Sectors to watch out for are:

§ Fertilizer- as the government may give incentives to encourage investment
§ Auto- import duties may be reduced, but the import of used cars, a major threat to the industry, is likely to remain banned
§ Cements- a likely further reduction in excise duty is expected, plus the government may announce some major construction projects which would boost the demand for cement

Inflation rising, could be followed by interest rates

One threat for the markets that needs to be kept an eye on now is rising interest rates. Cut-off yields in the latest 10-year PIB auction in April rose by 25 basis points to 6.49%, and this could signal further increases in the future. There is also the possibility of higher interest rates in the US, which would put pressure on the SBP to raise local interest rates too. We believe any adjustment to the interest rates will be gradual, and slight.

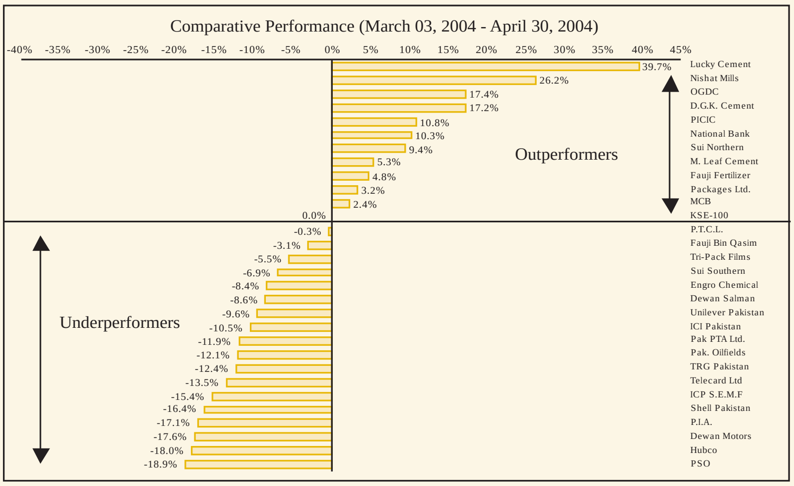
Inflation is up

Part of the problem is higher inflation, which is up due to rising prices of food items, as well as due to rising money supply. The currency in circulation increased 19% in the Jul03-Apr04 period, compared to 14.8% in the same period last year. The rising inflation could pose a problem for the economy unless controlled and will add to the pressure to raise interest rates.

High liquidity will drive share prices

Despite the threat of higher inflation and interest rates, the overriding impetus driving share prices is still liquidity. New funds continue to enter the market, as exemplified by the launch of Abamco's Rs3b Composite Fund, and its plans to launch two more funds of Rs1b each by June 2004. There have also been a number of new stock offerings – Callmate Telips, Southern Networks, Bank Alfalah, which serve to broaden and deepen the market and increase choice for investors.

On the whole, the trend remains positive, but we advise that the strong growth seen in the past two and a half years should not be expected, and investors should be careful about which stocks they choose.



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

Performance of Banks at a Glance

Selected Banks

(Rs. Bn)

	Major Banks				Private Banks				Foreign Banks		
	NBP	HBL	MCB	UBL	Askari	Al-Falah	Al-Habib	Union	SCB	Citibank	ABNAmro
Assets Net											
2000	371.64	328.61	174.72	161.57	38.45	28.86	24.23	27.09	35.10	49.02	39.24
2001	415.09	333.75	187.05	168.62	50.98	40.10	29.03	30.13	41.14	61.97	52.81
2002	432.80	403.04	235.14	183.00	70.31	65.17	49.44	55.83	81.13	62.15	45.72
2003	471.86	434.93	272.32	216.92	85.39	98.95	58.15	67.33	83.72	61.36	45.96
Deposits											
2000	316.49	266.05	135.99	128.68	30.36	20.48	17.82	17.17	27.34	36.18	29.58
2001	349.62	283.45	154.54	141.32	41.20	30.21	24.70	20.72	24.46	41.49	34.19
2002	362.87	328.18	182.71	158.26	51.73	51.69	34.24	37.76	56.44	40.84	34.70
2003	395.57	360.65	211.51	185.07	61.66	76.70	46.18	50.45	67.88	39.75	37.68
Advances											
2000	140.32	174.89	86.36	72.74	17.89	15.24	14.72	13.35	22.56	24.30	21.53
2001	170.32	167.23	76.58	77.94	23.29	19.13	15.90	13.87	21.50	27.12	23.86
2002	140.55	167.52	78.92	74.49	30.04	28.32	23.78	28.89	42.23	25.66	25.14
2003	160.99	183.66	97.20	103.28	44.78	49.22	35.23	40.41	39.95	25.29	23.43
Investments											
2000	72.61	68.07	43.11	33.78	8.65	4.88	1.29	3.81	2.62	2.60	0.51
2001	71.76	57.79	55.43	28.58	11.71	11.40	5.66	2.72	5.82	6.80	9.32
2002	143.53	142.88	89.58	69.24	26.74	24.47	18.83	11.82	17.65	11.28	8.94
2003	166.20	158.87	128.28	56.52	22.10	28.90	14.11	9.29	15.58	5.19	9.44
Net Interest Income											
2000	8.82	8.48	6.89	4.76	0.94	0.54	0.48	0.32	1.39	1.48	0.79
2001	12.41	11.30	9.49	5.12	1.35	0.88	0.78	0.60	1.07	2.31	1.28
2002	12.43	23.96	9.31	11.02	1.84	1.44	0.80	1.04	2.01	2.25	1.44
2003	12.72	19.27	7.44	8.94	2.69	2.01	1.26	1.77	2.91	1.98	1.49
Non Fund Based Income											
2000	4.03	6.14	2.76	3.49	0.63	0.27	0.35	0.50	0.85	1.20	0.70
2001	4.50	5.48	2.20	2.92	0.80	0.38	0.36	0.67	0.52	1.28	0.76
2002	5.21	6.19	2.59	3.27	0.85	0.70	0.70	1.01	0.96	1.90	0.79
2003	7.25	7.76	4.53	4.54	0.95	3.39	1.43	1.69	1.60	2.25	0.78
Admn Expense											
2000	8.01	12.08	7.13	5.47	0.68	0.50	0.40	0.72	0.94	1.49	0.69
2001	8.55	11.72	7.33	4.67	0.85	0.74	0.54	1.04	0.60	1.68	0.86
2002	9.14	11.81	7.55	5.39	1.09	1.18	0.76	1.56	1.20	1.71	0.91
2003	7.81	9.78	6.59	6.15	1.44	1.80	1.06	2.19	1.83	1.84	0.93
Profit/(Loss)B.T											
2000	1.03	0.97	1.32	1.67	0.75	0.40	0.40	0.01	0.78	1.03	0.76
2001	3.02	2.22	2.10	-5.73	1.01	0.52	0.55	0.01	0.69	1.77	1.17
2002	6.05	4.09	3.10	2.73	1.24	0.90	0.62	0.29	1.75	2.29	1.31
2003	9.01	5.47	3.61	4.33	1.90	3.51	1.51	0.57	2.69	2.36	1.32
Profit/(Loss)A.T											
2000	0.46	0.49	0.74	0.69	0.32	0.22	0.15	0.00	0.23	0.38	0.44
2001	1.15	1.11	1.11	-1.74	0.55	0.31	0.25	0.03	0.36	0.86	0.73
2002	2.25	2.03	1.74	1.41	0.69	0.45	0.29	0.16	1.04	1.06	1.03
2003	4.20	4.02	2.23	2.64	1.10	2.12	1.01	0.43	1.69	1.32	0.81
Employees (Nos)											
2000	15351	22779	12133	11879	1147	695	584	741	502	587	282
2001	15163	19352	11614	8899	1281	959	742	858	278	605	281
2002	12195	19005	10921	8446	1456	1504	1007	1127	594	637	272
2003	13272	18800	10164	8815	1723	2133	1253	1319	631	611	270
Branches (Nos)											
2000	1428	1755	1210	1390	29	21	41	27	15	8	7
2001	1245	1516	1061	1117	36	32	57	32	15	8	7
2002	1204	1473	1045	1112	46	45	57	34	20	8	7
2003	1199	1471	986	1077	58	59	70	43	20	8	7

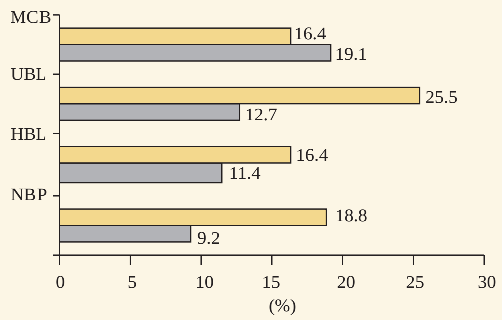
Annual Accounts of most banks have been published for the year ended December 2003. We shall be analysising their performance in a subsequent issue. Herewith we give some of the key figures of certain major banks and graphically show the behaviour of deposits by types.

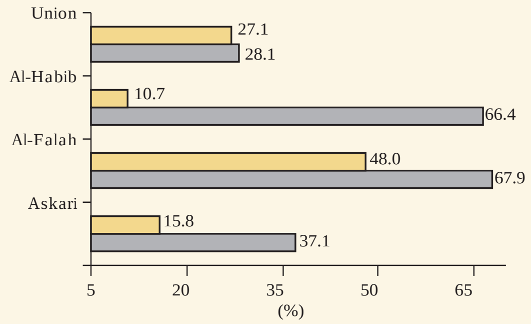
Deposit Growth of Selected Banks

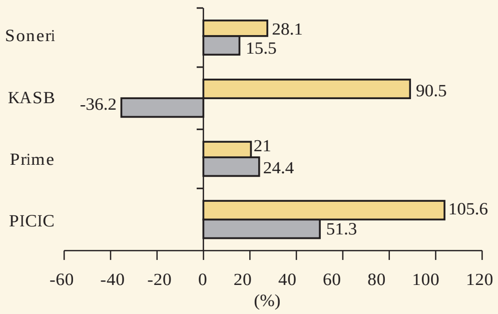
(year-on-year change in 2001& 2003)

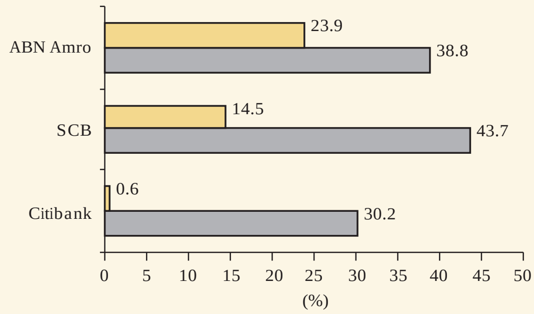
Saving Deposits

2001 2003



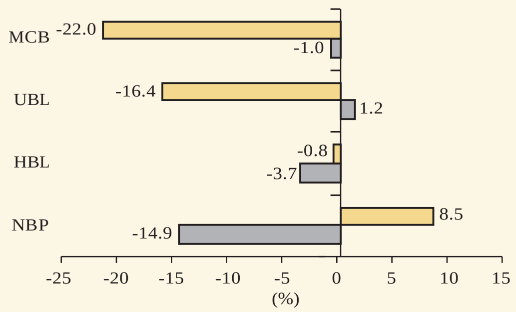


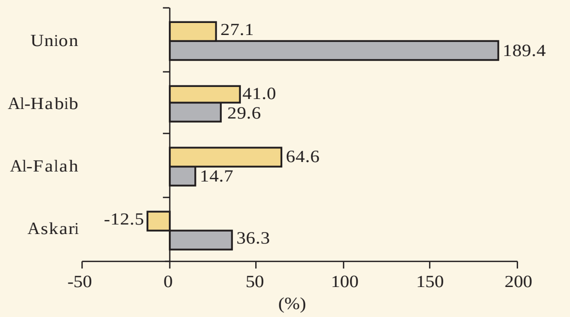


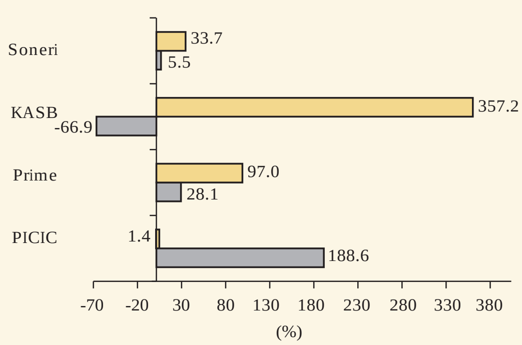


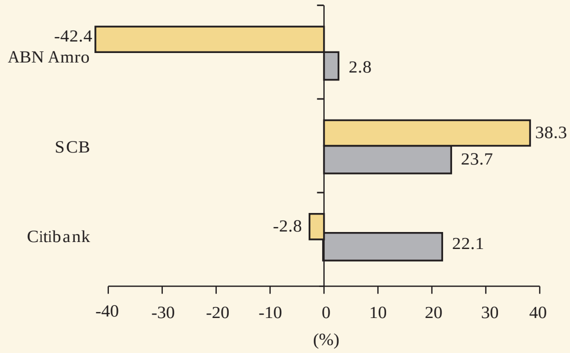
Fixed Deposits

2001 2003









Key Economic Indicators

Economy Size & Growth			1999-00	2000-01	2001-02	2002-03
GNP - Market Prices		Rs bn	3132.3	3372.4	3660.7	4201.7
GDP - Market Prices		Rs bn	3177.2	3423.1	3628.7	4021.1
Per Capita Income	Market Prices Rs		23031	24248	25767	28945
	Market Prices US $		441	415	419	492
Growth*						
GDP		%	3.91	2.09	3.49	5.08
Agriculture		%	6.09	-2.74	-0.07	4.15
Manufacturing		%	1.53	8.21	5.00	7.67
Wholesale & Retail trade		%	1.92	5.37	2.28	7.32
Rate of Inflation		%				
Consumer Price Index**			3.6	4.4	3.5	3.1
GDP Deflator			2.8	6.0	3.2	4.5
Balance of Payments		$ mn				
Exports (f.o.b.)			8190	8933	9140	10889
Imports (f.o.b.)			9602	10202	9434	11425
Trade Balance			-1412	-1269	-294	-536
Services Account (Net)			-2794	-3142	-2617	-2173
Private Transfers (Net)			3063	3898	4249	5737
Current Account Balance			-1143	-513	1338	3028
Fiscal Balance		% of GDP				
Total Revenue (Net)			16.3	16.2	17.2	17.7
Total Expenditure			22.5	21.0	22.8	22.1
Overall Deficit			6.6	5.2	5.2	4.4
Domestic & Foreign Debt						
Domestic Debt		Rs bn	1579	1731	1718	1852
As % GDP			50.2	50.6	47.3	46.1
Total External Debt		$ bn	32.3	32.2	33.4	33.4
As % GDP			53.1	54.9	56.6	48.5
As % Export Earnings			395.1	360.0	365.7	364.7
Investment & Savings		% of GNP				
Gross Investment			16.2	15.8	14.6	14.8
Fixed Investment			14.6	14.1	13.0	12.5
National Savings			14.3	14.9	16.8	18.5
Domestic Savings		% of GDP	15.8	16.5	16.9	16.2
Foreign Investment (net)		$ mn	543	182	475	820
Portfolio (net)			73	-140	-10	22
Direct (net)			470	322	485	798
Monetary Aggregates		%				
M1			14.9	3.0	15.2	26.2
M2			9.4	9.0	15.4	18.0
Interest Rates (Weighted Average)		%				
Deposits			5.47	5.27	3.60	1.61
Advances			13.52	13.61	13.19	9.40
Foreign Exchange Reserves^		$ mn	2163	3244	6398	10747
Exchange Rate++		Rs./$				
Official Rate			52.16	64.40	60.07	57.81
Open Market Rate			54.82	66.70	60.20	57.80

Source: SBP Annual Report 2002-03

* Constant Factor Cost of 1980-81
** Base 2000 - 01
^ Excludes FE 13/CRR and includes Indian pending transfers, new FCA and Trade Nostro.
++ End-June Buying Rate

NBP Performance at a Glance

(Rs. Bn)

Items	1999	2000	2001	2002	2003
Total Assets	350.4	371.6	415.1	432.8	471.9
Deposits	294.8	316.5	349.6	362.9	395.6
Advances	122.6	140.3	170.3	140.5	161.0
Investments	91.5	72.6	71.8	143.5	166.2
Shareholders' Equity	10.4	11.4	12.0	14.3	18.1
Pre-Tax Profit	0.52	1.03	3.02	6.04	9.01
After-Tax Profit	0.03	0.46	1.15	2.25	4.20
Earning Per Share (Rs.)	0.21	1.24	3.08	5.49	10.23
Return on Assets (Pre-Tax Profit) (%)	0.2	0.3	0.8	1.4	2.0
Number of Branches	1431	1428	1245	1204	1199
Number of Employees	15541	15351	15163	12195	13272

NBP Products

NBP Saiban

- Finance available for home purchase, home construction and home improvement.
- Period of repayment ranges between 3-20 years.
- Loans available upto a maximum of Rs.10 million.
- Mark-up choices available. Rate ranges between 7.5% – 9.75%.
- Minimum approval and disbursement timing.
- Limited to areas where there are no documentation, fee, resale and foreclosure related issues, so to protect the bank's interest.

NBP Advance Salary

- 10 month salaries in advance (certain conditions apply).
- Minimum documentation.
- Repayable in 5 years.
- No processing charges; no collaterals, no guarantees, no insurance.
- Mark-up charged at 11% per annum on reducing balance method.

NBP Cash n Gold

- Facility of Rs.5000 against 10 gms of gold.
- Mark-up 11% per annum.
- No maximum limit of cash.
- Repayable after one year.
- Roll over facility.
- No penalty for early repayment.

NBP Kisan Dost

- Loans available for the farmers for production, development purposes, for purchase of tractors, for installation of tubewells, for purchase of agricultural implements, mirco loans, for godown construction, for construction of fish pond, for livestock farming, for milk processing, for cold storage, bio-gas plants etc.
- Mark-up 11% per annum.
- Loans available at the farmer's doorsteps.
- Agricultural experts to guide farmers.
- Loans available against agricultural passbooks, gold ornaments and paper security.