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NBP Performance at a Glance

Editor's Corner

Dear Readers,

With growing interest in Islamic banking in recent years, the scepticism that prevailed about its success is giving way to an increasing realization that it is here to stay and progress. While Islamic banks have emerged as active players over the last two decades, but many of the principles upon which Islamic banking is based have been accepted all over the world for centuries. Today, there are about 250 Islamic financial institutions operating in about 100 countries.

In the last fifty years or so, the first half of which was devoted mainly to theory and model building, Islamic banking has established itself as an alternative to conventional banking. While the core ideal of commercial banking, that of financial intermediation was retained, but the practice of interest was discarded.

Islamic banking received greater attention as a banking option in the international financial scene in the 1970s. Its philosophies and principles are however, not new, having been outlined in the Holy Quran and Sunnah of Prophet Muhammad (PBUH) more than 1400 years ago.

Islamic banking has gained popularity not only in the Muslim world but in the west also. We see that there are Islamic financial institutions operating in the US, UK, India alongside Egypt, Iran, UAE, Malaysia, Saudi Arabia, Bahrain, Qatar, Pakistan, Turkey among others.

Today, Islamic banking is a growing sector, achieving mainstream relevance. For instance in Malaysia, the market share of Islamic banks' deposits is around 10%; Qatar and Kuwait 20%, Sudan 30%, Saudi Arabia 15%, UAE, Jordan and Egypt 15%.

UK's first purely Islamic bank, Islamic Bank of Britain opened in UK in mid 2004, offering financial products that comply with Islamic law. Some British banks offer products tailored for Muslims. Hong Kong & Shanghai Banking Corporation offers Shariah compliant pension, home loan scheme and stock broking service that comply with Islamic law (Shariah).

Citibank has set up an Islamic investment bank branch in Bahrain, while Chase Manhattan set up an Islamic bank in Bahrain as a separate entity, in collaboration with a local partner. Financial institutions like ABN Amro, Amercial Express, ANZ Grindlays Bank, Deutsche Bank and Union Bank of Switzerland have established Islamic Banking Shariah compatible services in several countries.

Islamic banking has been adopted at the national level in Pakistan, Sudan and Iran, and these countries have decided to Islamise the whole of their banking systems.

In Pakistan, Islamic banking has gone through an evolutionary process during the last three decades or so. Still in a stage of infancy, work continues, to make the system competitive with conventional banking practices. Today it is better aligned to the needs of business, as for many conventional banking practices there is a corresponding Islamic banking alternate. For instance, for long term financing there is Ijarah, for working term financing there is Murabaha, for deposits there is Musharika based Savings Accounts, for Letter of Credit there is Letter of Credit, for Letter of Guarantee there is Letter of Guarantee.

Further, an enabling environment is being created to make the system sustainable. Tax laws, civil laws, corporate laws, accounting standards are being reviewed and amended to meet the needs of the emerging system.

Presently Islamic banking operates side by side with conventional banking system. It was in 2002, that the State Bank of Pakistan issued the first Islamic banking licence to Meezan Bank and later in September 2004, a similar licence was issued to Al-Baraka Islamic Bank converting its operations to conform with Sharia. Further 9 banks have been issued with Islamic banking licences to open 29 branches. One bank has shown an interest to open a subsidiary and State Bank of Pakistan is looking into it.

The State Bank of Pakistan is playing a significant role in the development of Islamic banking in the country. As a regulator, it has a supervisory role to play, plus the role of policy maker and as the system in its infancy, the regulator has to play a developmental role as well.

A full-fledged Islamic Banking Department has been set up at the Central Bank. Realizing that it needs an undivided focused attention, the Department sees to the growth of the system in Pakistan.

The State Bank of Pakistan is following a three pronged strategy to promote Islamic Banking in Pakistan:

§ establishment of full-fledged Islamic banks in the private sector;
§ setting up of a subsidiary by an existing commercial bank;
§ setting up of separate branches for Islamic banking by an existing commercial bank, which is not touched by any conventional banking, so as not to conflict with the Shariah Board.

There is now a Shariah Board at the State Bank of Pakistan with a diverse group of experts to guide the Islamic banking industry.

As lack of qualified manpower is one of the biggest hurdles in the advancement of Islamic banking, bank staff need an orientation in the Islamic framework. State Bank is developing special certification courses, has undertaken various Islamic banking awareness programmes to train local staff and make them conversant with the details of Islamic financial instruments, accounting procedures etc.

Efforts towards Islamising the banking system in Pakistan has brought positive results in a short period. Total assets of Islamic banks has grown from Rs.12.9 billion (end-Dec ’03) to Rs.44 billion by the end of 2004. Deposits in the period grew from Rs.8.4 billion to 30.5 billion. Meanwhile, market share of Islamic banks/branches in terms of assets grew from a mere 0.5% (Jan ’03) to 1.36% (Dec ’04), while the share in deposits rose from 0.8% to 1.37%.

The Islamic banks branches have done well in the last one to two years, and this growth needs to be sustained. This would require investing in R&D, training of required personnel in the use of Islamic financial products, development/marketing of Islamic financial products by creating awareness among the muslim community of the developments in Islamic finance, developing compatible Islamic financial products among others.

Ayesha Mahmud

Abstract of the Bulletin

WTO and the Banking Sector

- § Since the establishment of the WTO in 1995, a number of agreements have been concluded between member countries to liberalise trade and one such agreement is the GATS.
- § GATS purpose is to create a reliable system of international trade rules, which ensures fair and equitable treatment of all countries on the principles of non-discrimination.
- § GATS covers all internationally traded services, including financial services, which includes insurance and banking.
- § Liberalisation of trade in financial services brings about a number of improvements.
- § GATS provides for four modes of supply of services.
- § There are a number of implications of opening of financial services.
- § Pakistan has a growing services sector.
- § It has a schedule of specific commitments in the financial services sector.
- § With liberalisation of the financial services sector, Pakistani banks will have to face increased competition.
- § Financial sector reforms initiated in 1997 were later strengthened and continue to-date.
- § The reforms have strengthened the local banks to compete with foreign banks both in the domestic market and internationally.

WTO General Agreement on Trade in Services and Pakistan

- § Services is a growing sector, offering a lot of export potential.
- § Pakistan has taken steps to liberalize its services sector under GATS.
- § While making sectoral commitments, Pakistan has placed certain limitations and restrictions.
- § While adopting liberalisation, certain gains as well as losses would accrue for the economy.

Banking Sector Quarterly Performance - 2004

- § The table shown in this section gives the key financial figures of banks whose quarterly balance sheets were published and were available.
- § Profit of all banks has risen in the fourth quarter of 2004.
- § Deposit increase in the second quarter of 2004 was more than in the third quarter for most banks.

Market Analysis

- § November and December 2004 marked the resumption of bullish sentiment in the equity markets. The KSE-100 Index managed to close the year at 6218 points, showing a gain of 39% for 2004 overall. Going forward, the momentum is likely to remain positive on the back of continued strong corporate earnings, easy liquidity, and the generally positive macroeconomic environment.

The Year 2004

- § Through graphical representation the monthly trend for the year 2004 of certain economic indicators is shown.

Book Reviews

- § There are some new books available in the market on Pakistan's economy, which have been introduced to our readers through a brief description of the contents of each book.

WTO and the Banking Sector

Beginning January 2005, the international trading system will change towards a regime which helps foster the free flow of trade in goods and services between its member countries. Trade has been progressively liberalized in both the developed and developing economies. With the establishment of the World Trade Organisation in 1995, a number of agreements have been concluded to liberalise trade in various sectors and one such agreement is the GATS – the General Agreement on Trade in Services. The GATS provides an international regulatory framework for administering global liberalisation of trade in services. It's major component is trade in financial services. The increasing importance of services trade led to the establishment of the GATS as one of the new areas in the Uruguay Round negotiations.

GATS liberalises trade

Financial services includes two broad categories of services; insurance and insurance related services, banking and other financial services. Banking includes all the traditional services provided by banks such as acceptance of deposits, lending of all types, payment and money transmission services, as well as services related to trading in foreign exchange and securities, money broking, asset management, settlement and clearing services.

Growing services sector

Earlier to the Uruguay Round, services were considered to offer less potential for trade expansion than goods, because of the existence of technical, institutional and regulatory barriers. But with the gradual liberalisation of the hitherto regulated sectors, it has enhanced the tradability of services. Liberalisation in the services sector is particularly important for developing countries considering the fact that trade in services has growth faster than trade in goods over the past decade.

Services account for over 64% of world gross domestic product, compared to 57% in 1990. Meanwhile, between 1990 and 2000, the growth of exports of commercial services for developing countries (9%), exceeded that for developed countries (5.5%). The 49% least developed countries also experienced particularly strong growth of commercial services (6.3%).

There are a number of studies which show the gains that accrue from liberalisation of services trade. World Bank Report *“Global Economic Prospects for Developing Countries 2001”*, has shown that economic gains from services liberalisation greatly exceed the gains from merchandise trade liberalisation. Liberalisation of services in developing countries could provide as much as $6 trillion in additional income in developing world between 2005-2015.

Gains from financial services liberalisation

Liberalisation of trade in financial services helps strengthen the financial system and the economy in general by bringing about improvements to the financial infrastructure. It also underpins efficient trade in goods. The presence of foreign financial firms encourages a competitive financial services market which in turn leads to increased efficiency, greater innovation, lower product pricing and increased consumer choice.

With the growing realization that the efficient supply of financial services is a precondition for stable development, is leading to increasing deregulation and liberalization of the sector. Over the last two or three decades, the scope for international trade in financial services has grown rapidly through the development of new technologies, especially in telecommunications, and the expansion of foreign direct investment.

Countries have taken steps, although at an uneven pace, to establish a framework of rules to ensure that service regulations are administered in a reasonable, objective manner.

The GATS Agreement defines trade in services as the supply of a service through any of the four modes.

Modes of supply

- Mode-1deals with cross border supply of a service. This category includes the taking of a loan or the purchase of insurance cover by a domestic consumer from a financial institution located abroad.

§ Mode-2 involves consumption abroad, the freedom for the Member's residents to purchase services in the territory of another Member. The purchase of financial services by consumers while travelling abroad falls in this category.

§ Mode-3 is commercial presence, the opportunities for foreign service suppliers to establish, operate or expand a commercial presence in the Member's territory, such as branch, agency, or wholly-owned subsidiary.

§ Mode-4 covers the supply of services through the presence of natural persons of a Member in the territory of another Member. It includes the possibilities offered for the entry and temporary stay in the Member's territory of foreign individuals in order to supply a service.

Removal of barriers to bring positive results

A book by the WTO and the World Bank *"The Internationalization of Financial Services: Issues and Lessons for Developing Countries"* has shown that with the elimination of discriminatory treatment between foreign and domestic financial services providers and the removal of barriers to the cross-border provision of financial services opens the door to the entry of foreign suppliers. There has been considerable support for the view that this favours the building of financial systems that are more stable and efficient by introducing international standards and practices.

Further, evidence exists which shows that increased competitiveness enhanced through financial sector openness spurs economic growth. The increased number of foreign entrants in the market has a positive effect on the functioning of the market.

The extent of the benefits depends largely on how it is phased in with other types of financial reform, particularly domestic financial deregulation. Multilateral agreements like GATS allows countries to add credibility to their plans for financial system liberalisation.

A paper entitled *"Financial Opening under the WTO Agreement in Selected Asian Countries: Progress and Issues"*, by the Asian Development Bank has examined the implications and issues of financial opening with focus on the banking sector for selected countries.

Implicat-ions of financial opening

With the opening of the banking sector to foreign banks, the paper has shown that Peoples Republic of China for instance will have to improve its legal and regulatory system to address existing weaknesses and prepare for future challenges, otherwise it would hamper financial sector development. Further the country would have to make its regulations consistent with its WTO commitment regarding opening up of the financial industry.

To strengthen domestic banks, the problem of non-performing loans have to be addressed; the private owned banking system has to be developed by ending the monopoly of major state owned banks and better human resources have to be developed so that skilled profe-ssionals are there to respond to the changing environment.

In Korea, the paper states 'foreign banks contributed to higher competition and introduction of new banking and financial techniques and helped Korean companies expand foreign trade with new clients.' Foreign equity holding of upto 100% in Korea is allowed for any kind of financial institution, while other countries restrict it to below 50% in general. There is evidence available which shows that financial opening has had a significant positive impact on the domestic economy and financial markets in Korea.

In Malaysia, the share of foreign banks' lending in total lending increased steadily after the Asian crisis, which contributed to the country's economic recovery, employment generation and financial stabilization in the period. As foreign banks generally enjoy more advanced banking practices than local banks, they contribute to introduction of new techniques into local markets.

Highlights of Individual Countries' Opening of Financial Services within GATS

Country	Banking	Equity Holding (Financial institutions)	Presence of Natural Persons	Other Restrictions
Indonesia	Branch offices operate only in 10 cities in principle. Foreign-Indonesian joint ownership is allowed with existing banks, but a new license is not allowed for GATS.	Local existing bank: 49% of the listed shares. Non-bank finance company listed in the stock exchange: 100% Others: 49%	Expatriate directors, managers, experts, advisors can be engaged for 3 years and can be extended. Manager or technical experts require two Indonesian under-studies at a minimum.	Cross-border supply and consumption abroad are generally prohibited. Securities brokers must establish a local company to run the business.
Korea	No restriction in general. In 1998 after the crisis, most restrictions were removed to increase commercial presence.	100% for any kind of financial institution. Stock investments in private companies: 100% (May 1998). Bond markets are fully open.	Allowed. Korean banks can recruit foreign nationals as directors (May 1998).	Cross-border and consumption abroad are partially allowed for banking and investment advisory services.
Malaysia	The 13 wholly foreign-owned foreign banks are permitted to remain wholly foreign owned. New licenses are not allowed.	Entry of foreign banks is limited to equity participation in local commercial banks and merchant banks. Aggregate foreign shareholding in a bank shall not exceed 30%. Securities company (a locally incorporated joint-venture): not to exceed 30%.	Not allowed except for temporary presence of senior managers and specialists in relation to establishing commercial presence.	For cross-border and consumption abroad, similar to Indonesia. Offshore institutions allowed in Labuan.
Singapore	One office only and cannot establish off-premise ATMs and new sub-branches. Money and foreign exchange market transactions generally unrestricted.	Banks: 40% Insurance: 49% of locally owned insurance companies. Securities companies: unbound.	Unbound, except for intra-corporate transfers of managers, executives, and specialist. Limited to a 3-year period that may be extended for upto two additional years.	For cross-border and consumption abroad, similar to Indonesia, but insurance is allowed.
Thailand	Commercial presence generally has no restrictions for existing foreign bank branches. Foreign bank share: zero in 1997, 6% as of December 2000.	Foreign equity participation upto 49% in principle. But the following only 25%: life and non-life insurance, local incorporated banks, securities companies.	Unbound, except for corporate transfers at the managerial or executive level, or for specialists for a 1-year period (altogether not more than three years).	For cross-border and consumption abroad, similar to Indonesia. Foreigners are not allowed to purchase or own land.

Source: Financial Opening under the WTO Agreement in Selected Asian Countries: Progress and Issues
Asian Develop

PAKISTAN

Banking (Financial Services)
Schedule of Specific Commitments

Modes of Supply: -
(1) Cross border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons.

Sector or Subsector	Limitations on market access	Limitations on national treatment	Additional commitments
Financial Services (excluding insurance)	The commitments in Financial Services are given to the nationals and financial institutions of the Members whose laws and policies do not bar the provision of similar commitments to the Pakistani nationals and financial institutions.	Provision of all banking and financial services in Pakistan are subject to the injunctions regarding Islamic banking as pronounced by the competent courts in Pakistan.	
Banking (a) Acceptance of deposits and other repayable funds from the public in Pakistan	(1) Unbound (2) Unbound (3) (i) Bound for the volume of deposits and other repayable funds mobilized by foreign banks in Pakistan as at the time of conclusion of the Negotiations on 12 December 1997. (ii) Foreign banks (other than those already operating their branches in Pakistan as on 12 December 1997) permitted to accept deposits and other repayable funds from public by setting up locally incorporated limited companies with foreign equity ownership upto 49%. Licence to undertake commercial banking business required from the Central Bank. The Licence to foreign banks will be issued on the basis of same eligibility criteria as applicable to domestic commercial banks. The minimum paid-up capital required to undertake banking business by foreign banks shall not be more than what is required by the domestic commercial banks, i.e. US$11.5 million. (iii) Bound for the number of branches of foreign banks operating in Pakistan as at the conclusion of the Negotiation on 12 December 1997. Change in the controlling shareholders of the foreign banks operating their branches in Pakistan may require new licence. Other foreign banks will be allowed upto three branches at the place of their choice. ATM's installed at the branch premises not treated as a separate branch. (iv) Prior permission in writing of the Central Bank is required by any person for holding beneficial ownership of 5% or more of the paid-up capital of any bank/financial institution. (v) Representation of foreign nationals on the Board of Directors allowed in proportion to their shareholding. (4) Unbound	(1) Unbound (2) Unbound (3) The shares held by foreign nationals and foreign financial institutions in their locally incorporated subsidiaries not transferable without the prior written approval of the Central Bank. (4) Unbound	
(b) Lending of all types including consumer credit, mortgage, factoring, credit and financing commercial transaction	(1) Unbound (2) Unbound (3) (i) Bound for the total volume of foreign banks' assets in Pakistan at the time of the conclusion of the Negotiations on 12 December 1997. (ii) Investment in shares of existing domestic banks permitted to foreign nationals/ foreign financial institutions for trading purposes. Acquisition of management control of existing public sector banks considered on case-by-case basis under specific Sale-Purchase Agreements to be approved by the Central Bank. (4) Unbound except as indicated under horizontal measures. Employment of foreign nationals in banks and financial institutions operating in Pakistan require prior clearance of the Central Bank.	(1) Unbound (2) Unbound (3) Lending by banks to companies controlled by non-residents is subject to the borrowing entitlements of the foreign companies as determined by foreign exchange rules applicable from time to time. (4) Unbound except as indicated under horizontal measures.	
(c) All payment and money transmission services including traveller cheques and banker's draft (but excluding credit, charge and debt cards)	(1) Unbound (2) Unbound (3) Foreign banks branches operating in Pakistan at the conclusion of the Negotiation on 12 December 1997 and banks incorporated in Pakistan permitted to undertake all payment and money transmission services. (4) Unbound except as indicated under horizontal measures.	(1) Unbound (2) Unbound (3) Unbound (4) Unbound except as indicated under horizontal measures.	

(1) Cross border supply (2) Consumption abroad (3) Commercial presence (4) Presence of natural persons.

Sector or Subsector	Limitations on market access	Limitations on national treatment	Additional commitments
(d) Guarantees and commitments	(1) Unbound (2) Unbound (3) Guarantees and commitments in foreign currency and those undertaken in favour or on behalf of non-resident to be governed by foreign exchange laws. (4) Unbound except as indicated under horizontal measures.	(1) Unbound (2) Unbound (3) Unbound (4) Unbound except as indicated under horizontal measures.	
(e) Trading, for own account only of: - money market instruments; - foreign exchange; - transferable securities; - other negotiable instruments	(1) Unbound (2) Unbound (3) (i) The issue, sale and purchase of foreign currency and traveller cheques is allowed to commercial banks licensed as Authorized Dealer. (ii) Foreign banks allowed to set up joint ventures with local persons with equity participation upto 50% after obtaining Licence from the State Bank to undertake the sale and purchase of foreign currency and traveller cheques. (iii) Transmission of permissible funds including foreign currency can be effected only through authorized banking channels. (iv) Commercial banks incorporated in Pakistan and the branches of foreign banks in operation as on 12 December 1997 allowed to operate in call money market. (4) Unbound except as indicated under horizontal measures.	(1) Unbound (2) Unbound (3) Unbound (4) Unbound except as indicated under horizontal measures.	
(f) Participation in issues of all kinds of securities including only public underwriting and placement as agent and provision of services related to such issues	(1) Unbound (2) Unbound (3) Branches of foreign banks in operation as on 12 December 1997 and banks (including investment banks) incorporated in Pakistan permitted to arrange and participate in any public issue and underwriting of securities upto 30% of the total paid-up capital of the issuer or 30% of their respective paid-up capital which ever is less. All investments in shares made as a consequence of underwriting commitments must be reported forthwith to the Central Bank, and is required to be disinvested within 30 days of the investments as approved by the Central Bank. (4) Unbound except as indicated under horizontal measures.	(1) Unbound (2) Unbound (3) Unbound (4) Unbound except as indicated under horizontal measures.	
(g) Settlement and clearing services for negotiable instruments (cheques, bills and promissory notes only)	(1) Unbound (2) Unbound (3) All commercial banks are required to be members of the clearing system operated/ approved by Central Bank to effect interbank settlements. (4) Unbound except as indicated under horizontal measures.	(1) Unbound (2) Unbound (3) Unbound (4) Unbound except as indicated under horizontal measures.	

In the country's schedule each country identifies the service sectors to which it will apply the market access and national treatment obligations of the GATS and any exceptions from those obligations it wishes to maintain. The commitments and limitations are entered with respect to each of the four modes of supply which constitute the definition of trade in services in Article 1 of the GATS: these have been mentioned earlier.

The national schedules all conform to a standard format. For each service sector or sub-sector, the schedule indicates, with respect to each of the four modes of supply, any limitations on market access or national treatment which are to be maintained. A commitment therefore consists of eight entries which indicate the presence or absence of market access or national treatment limitation with respect to each mode of supply.

§ *Market access column:* When a Member undertakes a commitment in a sector or sub-sector it must indicate for each mode of supply what limitations, if any, it maintains on market access.

§ *National treatment column:* The national treatment obligation under Article XVII of the GATS is to accord to the services and service suppliers of any other Member treatment no less favourable than is accorded to domestic services and service suppliers. A Member wishing to maintain any limitations on national treatment – that is any measures which result in less-favourable treatment of foreign services or service suppliers – must indicate these limitations in the third column of its schedule.

§ *Additional commitments column:* Entries in this column are not obligatory but a Member may decide in a given sector to make additional commitments.

In essence, the entries which constitute a legally binding commitment in a Member's schedule indicate the presence or absence of limitations on market access and national treatment in relation to each of the four modes of supply for a listed sector, sub-sector or activity.

§ Where there are no limitations on market access or national treatment in a given sector and mode of supply, the entry reads NONE.

§ All commitments in a schedule are bound unless otherwise specified. In such a case, where a Member wishes to remain free in a given sector and mode of supply to introduce or maintain measures inconsistent with market access or national treatment, the Member has entered in the appropriate space the term UNBOUND.

Pakistan and the GATS

The significance of the services sector in the economy of Pakistan has grown over the years and today the sector constitutes over 52% of the GDP and accounts for around 45% of the total labour force employed in the country. Individual shares in the services sector sub-category shows that the wholesale and retail trade sector claims the highest share (18.4%) followed by transport, storage and communication (11.1%) public administration & defence (6.8%), ownership of dwellings (3.1%) and finance & insurance (3.0%). The remaining services grouped under other services have a share of around 10%.

The preceeding Table gives the schedule of specific commitments Pakistan has made in the financial services (banking) sector. Each WTO member is required to have a Schedule of Specific Commitments which identifies the services for which the member guarantees market access and national treatment and any limitations that maybe attached.

In the opening paragraph of the schedule of specific commitments, Pakistan has stated that the commitments laid down in the schedule are subject to the availability of similar commitments from other countries whose law does not bar the provision of similar commitments to our financial institutions.

The government improved its financial services commitments in the WTO Financial Services Agreement in December 1997. The following are excerpts from a report *"WTO Regime and its Impact on Pakistan"*, by the Civil Services Academy, Lahore.

The State Bank of Pakistan (SBP) has changed its branch licensing policy, and has eliminated restrictions on the number of branches for foreign banks. Currently foreign banks, like local banks, have to submit an annual branch expansion plan to the SBP for approval. The SBP approves new branch openings based on the bank's net worth, adequacy of its capital structure, future earning prospects, credit discipline, and the needs of the local population. Foreign brokers, like their Pakistani counterparts, must register with the Securities & Exchange Commission of Pakistan.

Some other Commitments

- Foreign banks have been allowed to undertake business by setting up locally incorporated subsidiary with 49% foreign equity.
- Other eligibility criteria including minimum capital requirement, is the same as for domestic commercial banks.
- Investment in shares of existing domestic banks is permitted to foreign nationals/IFIs for trading purposes.
- Representation of foreign nationals on the board of directors has been allowed in proportion to their share holdings.
- Employment of foreign nationals in banks and financial institutions operating in Pakistan require prior clearance of SBP.
- Foreign banks are allowed to setup joint ventures with local persons with equity participation up to 51%.
- Transmission of permissible funds, including foreign currency, can be effected through authorized banking channels.
- All commercial banks are required to be members of the clearing system operated/approved by SBP.
- Foreign leasing companies are permitted to setup subsidiary leasing business with maximum total share holding of 51%.
- Foreign licensed entities are allowed to undertake portfolio management services by setting up locally incorporated subsidiaries with 51% share holding.
- Prior written permission is required by SBP for any person holding more than 5% of paid up capital of any bank/FI.

Proactive role for SBP

Liberalisation does not mean no checks and balances. It is important to have sound regulations and controls in place for banking sector, it means a more proactive role by SBP. In addition to Pakistan's commitment, further liberalisation has taken place over the years.

The preferences for joint venture subsidiary, with foreign equity participation limited to 49%. The banks from ECO countries and other regional bodies such as SAARC would be given preferential treatment in this regard. Foreign banks are allowed to operate up to 50 branches. ATM's installed in non-branch locations are not treated as a separate branch.

All prudential regulations are uniformly applicable to foreign banks as well as local banks. There is no discrimination. In addition to authorized banks, license exchange companies are also allowed to transmit permissible funds. Commercial banks are allowed to undertake leasing business, provided it should not be its major line of business.

Increased competition

As the agreement on GATS changes the texture of international banking substantially, the Pakistani banking industry will have to compete with other banks domestically and also increase their presence on the international banking scene, in accordance with the liberal policies adopted by all countries under the WTO regime. They will have to benchmark themselves against the best in the world. Liberalisation would affect the banks' profitability, development and market share, levels of risk and the quantity and quality of financial services.

History has shown that banks that are not prepared can face financial crisis, as happened in Mexico in 1996. Brazil and Venezuela faced similar experiences in 1996. In all three cases, financial crises occurred following intensive liberalisation to the banking sector. Reasons cited were: excessive lending activity before liberalisation, lack of information available to investors about banking principles etc.

It is against the above background that we consider the process of financial reforms in Pakistan and how they have transformed the local banking scene.

Financial sector reforms in Pakistan

Financial sector reforms began in 1997 and were further strengthened in 2001. Banking sector reforms were undertaken as part of a comprehensive package of structural reforms. In the early 1990s Pakistan's banking sector was beset with a host of problems; dominance of public sector financial institutions had resulted in financial inefficiencies, crowding out of the private sector, deteriorating quality of assets, ineffective supervisory system, lack of governance in state-owned institutions, poor credit discipline led to worsening level of non-performing loans. Inefficiencies due to overstaffing and over branching were continuously adding to the administrative cost of public sector institutions. Data disclosure standards were not resulting in conveying the full picture of financial health of the institutions. Capital erosion was witnessed in the state-owned banks.

The financial sector reforms begun in the early 1990s, liberalized the banking sector by permitting private banks to operate. Four major nationalised commercial banks were privatised, governance of financial institutions was strengthened by amendments to the Banking Companies Ordinance 1962. Loan recovery process was streamlined, a number of state-owned banks and development financial institutions were downsized and restructured through golden handshake and branch closure programmes in the later half of the 1990s.

Prudential measures were strengthened. Several steps were taken to enhance the effectiveness of the State Bank of Pakistan: autonomy was granted to SBP in matters related to administration and conduct of business, formulation and implementation of monetary policy; regulatory function of SBP was consolidated and supervisory role was enhanced. Banking laws also underwent significant changes to provide a supportive framework for the reform process.

Reforms bring positive changes

Financial sector reforms has brought marked improvement in the financial health of commercial banks in terms of capital adequacy, profitability and asset quality as also greater attention to risk management. Privatisation of public sector banks and the ongoing process of mergers/consolidation brought visible changes in the ownership structure and concentration within the sector. Banking sector concentration has declined, providing a level playing field for the participants. Further the outreach of services to the underserved segments of population has increased. By diversifying their lending portfolios the banks have mitigated the risk and helped large numbers an access to the credit market.

The Central Bank has also strengthened its regulatory capacity. It is now more proactive in aligning its regulatory profile in a rapidly changing domestic and global financial environment. The banking regulation and supervision are now fully compliant with the international standards and codes prescribed by Basle Committee. Commercial banks have been encouraged to adopt the best corporate governance practices, Banks operating in Pakistan how have in place, a code for corporate governance for the benefit of all stakeholders. Introducing internationally followed best practices and observing universally acceptable standards and codes is necessary for strengthening the domestic financial architecture. In today's globalised world, focusing on the observance of standard will help smooth integration with world financial market.

As a consequence of such reforms, Pakistani banks have been strengthened to compete with foreign banks both in the domestic market and internationally. As the process of closer external linkages gathers momentum and competition intensifies, domestic banking system could expect to face increased competition with an emphasis on improving customer services, reduction of costs and strengthening of prudential norms, better risk management, higher level of professional expertise, technological up-gradation and overall efficiency.

Mention must be made of the emphasis banks are laying on training their staff to acquire new skills and technologies in order to survive the competition that they will face. Should the free flow of labour across national borders increase substantially, the need for skilled and trained local labour force is of paramount significance.

Special skills in retail banking, risk management, treasury, foreign exchange, development banking etc will need to be carefully nurtured and built to manage risks and meet the demand for specialized banking functions.

The corporate world is changing and no institution can afford to be complacent about it. The human resource managers have to train the available manpower to face the challenges and opportunities resulting from competition.

With financial liberalisation under the WTO, banks in Pakistan will have to benchmark themselves against the best in the world. They will have to tackle significant issues, while achieving economies of scale through consolidation and exploring cost effective solutions.

As the first generation of reforms in the financial sector of Pakistan has been completed successfully, the State Bank of Pakistan is planning for the second generation of reforms to further deepen the financial sector and integrate it into the global economy.

WTO General Agreement on Trade in Services and Pakistan

*Ahmad Mukhtar **

The contribution of services in most of the countries' GDP is significant yet neglected as far as policy priorities are concerned. In Pakistan services are around 53% of GDP. The share of services in world trade is increasing swiftly, however, most of the trade in services is amongst the developed countries. India and China being the outsourcing hubs are there in services markets too, as main suppliers from the developing world. There is a lot of potential in exporting services for the developing countries. Before the conclusion of Uruguay round of trade negotiations there was no formal international mechanism in place for trade in services. It was the WTO that coupled the trade in services along with trade in goods.

Share of services resing

General Agreement on Trade in Services (GATS) regulates and brings international trade in services under the multilateral discipline of the WTO regime. It intends to secure progressively higher levels of liberalization of trade in services through successive rounds of negotiations. The member countries are required to specify in their schedules of commitment under GATS the terms, conditions and limitations applied on various service sectors. The members have also to specify in their schedule, the limitations on National Treatment, i.e., whether the treatment extended to service suppliers of other countries will be identical or different as compared to the treatment given to the domestic service providers.

GATS

When WTO Agreements came into operation on 1st January 1995, negotiations for liberalization of services sector were not complete and it was agreed to supplement the commitments in 1997. So most of the members scheduled partial commitments at that time in 1994 which were improved upon in 1997.

The Services are classified into 12 broad sectors and more than 160 sub-sectors according to WTO Classification of Services. List of broad sectors are as under:

- Business
- Communication
- Construction and Engineering
- Distribution
- Education
- Environment
- Financial Services
- Health
- Tourism and Travel
- Recreation, Cultural and Sporting
- Transport
- Other

There are four recognized ways of exporting services from one country to another under the Agreement. These are called modes of supplying service under GATS.

The four different Modes

Mode l: Also called *Cross Border Supply* of services. This is supply of a service from the territory of one Member into the territory of another, such as telephone call and communication services.

Mode 2: This is also known as *Consumption Abroad* of service and occurs when consumer moves to the territory of another country and buys services there or when the property of the consumer is sent abroad for servicing, as in the case of ship repair, tourism and education abroad.

Mode 3: Commonly known as *Commercial Presence* of service providers. This is establishment of a business entity for the purpose of supplying a service. Examples are branches of the banks, insurance companies, engineering services, etc.

Mode 4: Also described as *Movement of Natural Persons*. This is temporary presence of an individual for the purpose of supplying a service in the export market. This person could be the service supplier himself or an

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employee of the service supplier. In both case, the GATS definition covers only the temporary stay of such persons and is not the same as immigrating to the country. Examples of such service providers are doctors, teachers, accountants, nurses or lawyers etc going abroad to temporarily supply their services.

Doha mandate on GATS

The 4th WTO Ministerial Conference held in Doha, Qatar in November 2001 authorized the launching of a new round of multilateral trade negotiations. The agenda of negotiations or the Doha Development Agenda inter-alia includes further liberalization of trade in services and mandates the adoption of a request/offer approach in this regard. In the first phase WTO members were expected to submit initial requests to individual countries by 30th June 2002. Thereafter, WTO members were expected to respond to these requests by making initial offers upto 31st March 2003.

It needs to be mentioned here that these dates were indicative rather than limiting in nature. For instance, though 30th June 2002 was the deadline for submitting initial requests, the member countries were not prevented from making requests as well as amending or adding to their request lists in terms of sectors or countries at any subsequent time. In practice therefore, only a few countries submitted their initial requests by that date. The same is true for initial offers and it is visualized that subsequently we will continue to see requests and offers till these negotiations are finally concluded. The negotiations on GATS are targeted to be concluded by May 2005, although there is widespread doubt that this time schedule will be adhered to.

Under these negotiations, Pakistan has received requests from various WTO member countries for liberalizing its services sectors. Most of the countries are interested in liberalizations of Telecom, Finance and Business services. Pakistan has also sent requests to various countries asking for liberalizations in their service sectors. Now, like other WTO member countries, Pakistan has to come up with initial offers followed by final offers (consequently to be taken as commitment) for further liberalization in its services sectors.

Pakistan has made commitments under GATS in the following service sectors:

Pakis-tan's existing commit-ments under GATS

- Business
- Communication
- Construction and Engineering
- Financial Services
- Health
- Tourism and Travel Services

While making commitments in the above sectors, Pakistan has placed horizontal restrictions across all the service sectors which are uniformly applied to all the sectors. To quote some restriction as examples, it may be mentioned that the foreign firms can have upto a maximum of 51% equity in their local business in Pakistan and 50% of the executives or specialists in any company could be foreigners. Some other examples of these limitations are that the local commercial offices of the foreign firms are required to meet their local expenses by remittances from abroad. The acquisition of real estate is subject to authorization on case-to-case basis.

Sectoral commit ments

As an illustration of Pakistan's sectoral commitments, it may be mentioned that the licenses granted in banking sectors are on the basis of reciprocity i.e. only to the banks of the countries that also grant license to Pakistani banks. We also give favorable treatment to the banking institutions established as joint venture under the ECO framework and Islamic financing. Pakistan has made more commitments regarding allowing the foreign companies/firms to establish their subsidiaries in Pakistan because this serves as an incentive for foreign direct investment. In computer and related services, Pakistan has adopted liberal approach in allowing consumption of services in other countries and has granted permission to foreign companies to establish their affiliates in Pakistan. In construction and related services, foreign firms are required to have partnership and / or joint venture with Pakistan companies. In health services, we have imposed no restrictions in consumption of services in other countries and have allowed foreign service suppliers to establish their commercial presence subject to regulations of Pakistan Medical & Dental Council.

What do we need before further liberalization?

In the context of initial offer to be made by Pakistan, a number of factors need to be kept in mind. Firstly, Pakistan has already made some binding commitments in the services sector during the Uruguay Round followed by additional commitments in the financial and telecom sector in 1997. Secondly, whatever offers are now made by Pakistan in response to the requests received or otherwise will automatically be available to all WTO members on most favored national (MFN) basis. Thirdly, Pakistan has to determine whether on balance it would be better off going for maximum possible liberalization or alternatively adopt a defensive posture and liberalize to the minimum extent in order to afford maximum protection to Pakistani service providers in the domestic context.

Before coming to any conclusions on the general posture to be adopted it would be useful to consider the possible dangers of going for maximum liberalization. For one allowing easier importation of services from Foreign Service providers could displace domestic service providers and thus create unemployment. Secondly, such a development could increase the quantum of transfer of resources abroad in the form of profits. The third result could be transfer of control of service delivery mechanisms and sectors from national to foreign entities, and this may create difficulties and vulnerabilities in areas of national strategic importance.

On the other hand if viewed from the macro perspective, there may be much greater benefits than losses in adopting the liberalization option.

For one opening up the services sector will mean foreign service providers bringing in higher quality services and this would inevitably lead to some transfer of technology.

Secondly, due to foreign competition domestic service providers will be forced to become more efficient and upgrade their service delivery resulting in benefits for consumers as well as producers and better prospects for export of our services.

Thirdly, due to foreign competition, availability of a higher quality, more efficient yet cheaper service infrastructure will mean lower production costs for our exporters thereby making our exports more competitive.

Fourthly the dangers referred to in the preceeding para may be significant and relevant for the short term since in the longer term structural adjustments would be able to compensate.

Fifthly as it happens Pakistan has liberalized a number of its service sectors already without any ill effects and what we would really be doing is to bind ourselves that we will not rollback our existing concessions. Sixthly of course the more we liberalize and bind ourselves down, the better prospects Pakistan will have as a destination for foreign direct investment (FDI).

Pakistan's autonomous liberalization

So far Pakistan has made commitments under GATS in a conservative manner with a view to affording maximum protection to domestic service suppliers. However, in practice, Pakistan is following a policy, which is much more liberal than it is obliged to follow under GATS commitment. This autonomous liberalization is clearly spelled out in the Investment Policy of Pakistan through which 100% foreign equity is allowed although we have committed a maximum of 51% in our schedule. Similarly, in the Education, Tourism and Financial Sectors, we are more liberal compared to our level of commitments. This liberalization has either been done under our structural adjustment programmes with the IFIs or due to our own assessment of our interests. One option may therefore be to commit ourselves upto the limit of our existing liberalization in the services sector.

Initial offer by other countries

So far around 72 countries have submitted their initial offers through the WTO Secretariat. These countries include developed countries like USA, Canada, Australia, New Zealand and Japan as well as the developing countries like India, Paraguay, Uruguay, Panama, Argentina, Bahrain and Macao. All countries have made conditional offers reserving the rights to withdraw, amend or reduce the offers or making technical changes.

Some developed countries like USA, Japan, New Zealand and Norway have made substantial improvements in their schedules. These improvements are common in insurance, environment, and communication sectors. Some improvements in mode 4 are also evident. Other developed countries like Switzerland, Canada and Australia have liberalized their services to a lesser extent and have made more cosmetic changes. Australia however has made improvements in Banking and Environment sectors.

Developing countries have been more cautious in making offers and have marginally improved upon their existing schedules. Most of the offers are visible in Environmental, Tourism, Express delivery and Business Sectors. The Financial and Telecommunication sectors have not been liberalized to a greater extent. Maximum offers have been offered under mode 2. Many countries have made commitments in maritime transport including developed and developing countries.

Banking Sector Quarterly Performance at a Glance - 2004

(Rs.Bn)

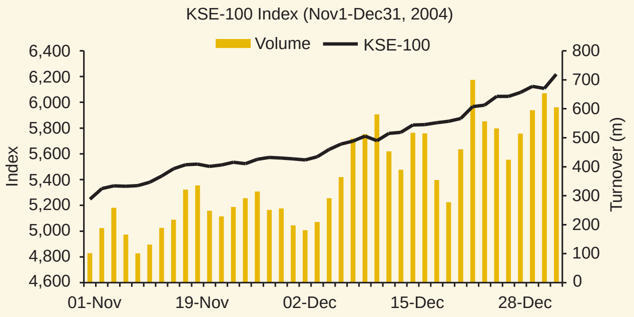
	Major Banks						Provincial Banks		Domestic Private Banks[a]													Foreign Banks[b]						
	National Bank of Pakistan	Habib Bank	United Bank	Muslim Comm. Bank	Allied Bank	First Women Bank	Bank of Punjab	Bank of Khyber	Askari Comm. Bank	Soneri Bank	Bank Al-Habib	Bank Al-Falah	Union Bank	Bolan Bank	Metropo-litan Bank	Faysal Bank	Prime Comm. Bank	KASB Bank	Picic Comm. Bank	Saudi Pak Comm. Bank	Meezan Bank	Standard Chartered	Citibank	ABN Amro Bank	American Express	Habib Bank AG. Zurich	KongKong & Shanghai Banking Corp.	Oman Bank Interna-tional
Assets																												
2003 Dec.	471.9	418.1	225.4	272.3	117.5	9.7	43.6	19.8	85.4	37.0	58.1	99.0	67.3	11.7	59.0	47.6	29.6	9.0	40.1	35.1	11.1	83.7	61.4	46.0	10.0	32.9	10.1	1.8
2004																												
QI March	471.0	436.1	215.9	257.0	NA	9.8	43.6	19.2	89.5	40.0	63.2	105.1	67.2	10.9	64.5	53.5	30.5	8.7	41.4	35.6	12.9	86.9	58.5	45.7	8.4	36.2	10.4	1.9
Q2 June	528.7	432.9	239.8	265.6	132.0	9.8	55.3	20.8	96.0	43.7	67.1	127.6	78.4	14.0	62.7	58.3	33.2	11.1	45.7	40.3	13.9	95.7	67.4	54.4	10.9	38.3	10.4	2.0
Q3 Sept	516.2	444.2	239.5	256.2	143.5	9.5	55.0	20.5	107.7	46.5	73.6	142.6	79.0	11.6	66.2	69.0	36.3	13.8	47.7	39.4	16.1	99.5	69.4	55.3	11.1	38.3	12.1	2.0
Deposit																												
2003 Dec.	395.6	345.4	189.8	211.5	114.3	8.1	34.9	15.4	61.7	27.9	46.2	76.7	50.5	9.0	39.3	31.3	21.6	5.4	32.5	24.6	7.8	67.9	39.7	37.7	5.1	22.9	7.3	0.7
2004																												
QI March	408.1	371.1	187.6	221.2	NA	8.6	34.6	15.0	66.4	28.9	50.3	77.4	53.0	8.4	43.6	34.8	23.0	5.6	33.4	26.5	8.5	69.7	39.7	39.6	5.4	23.6	6.3	0.8
Q2 June	454.2	366.4	200.3	223.8	126.4	8.5	44.3	16.7	73.0	33.3	54.3	92.0	59.4	10.1	42.9	42.5	26.0	7.4	38.2	30.0	9.4	74.9	39.7	43.8	5.8	25.2	6.9	0.7
Q3 Sept	443.2	366.4	199.1	216.5	124.9	7.7	43.6	14.0	77.9	34.5	58.8	100.5	61.8	9.2	46.3	49.9	26.4	8.7	39.2	28.7	9.8	82.0	48.8	44.0	5.4	27.1	8.3	0.6
Advances																												
2003 Dec.	161.0	178.9	103.3	97.2	40.7	1.3	18.3	5.4	44.8	17.3	35.2	49.2	40.4	4.5	32.2	29.4	13.7	1.8	14.3	18.5	7.4*	39.9	25.3	23.4	2.4	17.4	5.0	0.3
2004																												
QI March	156.4	191.4	101.6	87.8	NA	1.3	20.4	6.0	48.3	19.7	40.6	52.4	42.6	3.7	35.8	34.0	15.1	3.4	16.3	20.9	8.5*	43.8	25.1	25.5	2.2	20.0	5.1	0.3
Q2 June	195.3	206.0	122.4	98.0	41.6	1.3	26.8	6.3	55.5	20.7	40.5	63.2	47.6	5.0	35.6	37.7	17.2	4.8	19.0	23.7	9.6*	50.4	24.3	27.0	2.2	21.2	4.7	0.6
Q3 Sept	187.4	216.3	125.0	103.9	40.3	1.3	30.4	6.1	59.8	22.0	41.0	75.8	48.7	4.8	37.9	45.0	18.5	8.4	21.3	23.0	11.1*	49.0	28.9	29.0	2.2	22.9	4.8	0.5
Investment																												
2003 Dec.	166.2	153.8	54.6	128.3	40.7	5.3	11.5	9.5	22.1	11.9	14.1	28.9	9.3	1.9	18.0	11.4	9.8	2.4	21.7	9.4	1.2	15.6	5.2	9.4	2.3	9.9	0.2	0.1
2004																												
QI March	190.6	163.3	58.6	114.6	NA	4.8	12.8	8.4	21.1	13.4	12.4	36.2	9.2	2.0	16.6	11.3	9.6	1.9	20.5	8.5	1.5	15.7	3.9	8.2	2.5	10.7	0	0.1
Q2 June	158.3	150.1	52.6	108.7	47.6	4.7	14.9	8.0	20.3	14.8	11.5	43.6	10.0	2.6	15.6	11.4	8.6	2.8	15.5	7.6	1.2	21.4	5.9	8.8	2.5	9.4	0	0.1
Q3 Sept	189.6	139.2	46.2	94.6	61.2	3.9	15.9	7.2	18.6	14.2	16.1	40.9	9.8	2.0	15.6	11.4	7.8	2.4	14.3	9.1	1.2	15.0	3.2	6.5	2.9	7.4	0.5	0.09
Int.Income																												
2003 Dec.	19.5	19.3	9.3	10.4	5.0	0.5	1.7	1.5	4.1	1.7	2.4	4.0	3.5	0.5	2.7	2.1	1.5	0.4	2.6	1.3	0.4	3.8	3.3	2.1	0.3	1.6	0.3	0.08
2004																												
QI March	4.5	4.0	1.8	2.2	1.0	0.1	0.5	0.3	0.9	0.4	0.5	1.1	0.9	0.09	0.7	0.5	0.3	0.1	0.7	0.4	0.1	0.7	0.7	0.4	0.05	0.3	0.05	0.01
Q2 June	4.8	4.0	1.9	2.3	1.0	0.1	0.5	0.6	1.0	0.5	0.5	1.3	1.0	0.1	0.7	0.6	0.4	0.2	0.6	0.5	0.1	0.8	1.4	0.5	0.05	0.4	0.06	0.01
Q3 Sept	4.9	4.5	2.3	2.3	1.6	0.1	0.6	0.3	1.2	0.5	0.6	1.5	1.1	0.08	0.7	0.7	0.4	0.2	0.7	0.5	0.1	1.0	2.2	0.6	0.06	0.4	0.07	0.01
Int.Expense																												
2003 Dec.	6.7	5.7	1.9	2.9	1.2	0.2	0.5	0.7	1.4	0.8	1.1	2.0	1.7	0.1	1.3	0.9	0.6	0.2	1.5	0.9	0.2	0.9	1.3	0.7	0.2	1.1	0.1	0.06
2004																												
QI March	1.5	1.1	0.3	0.5	0.2	0.03	0.1	0.1	0.2	0.2	0.2	0.5	0.3	0.03	0.3	0.2	0.1	0.06	0.4	0.3	0.05	0.1	0.2	0.08	0.02	0.2	0.02	0.006
Q2 June	1.8	1.0	0.4	0.5	0.2	0.02	0.1	0.2	0.2	0.2	0.2	0.5	0.3	0.03	0.3	0.2	0.2	0.07	0.3	0.3	0.05	0.1	0.4	0.1	0.02	0.2	0.02	0.005
Q3 Sept	1.8	1.3	0.4	0.5	0.2	0.03	0.2	0.08	0.3	0.2	0.3	0.6	0.4	0.04	0.3	0.3	0.2	0.08	0.3	0.3	0.06	0.2	0.6	0.1	0.04	0.2	0.03	0.004
Net.Int.Income																												
2003 Dec.	12.7	13.6	7.3	7.4	3.8	0.3	1.2	0.8	2.7	0.9	1.3	2.0	1.8	0.4	1.4	1.1	0.8	0.2	1.1	0.4	0.2	2.9	2.0	1.5	0.1	0.5	0.2	0.02
2004																												
QI March	3.0	2.8	1.5	1.7	0.9	0.09	0.4	0.2	0.7	0.2	0.3	0.6	0.6	0.06	0.4	0.3	0.2	0.06	0.3	0.1	0.05	0.6	0.5	0.4	0.03	0.1	0.03	0.005
Q2 June	3.0	3.0	1.5	1.8	0.8	0.09	0.4	0.4	0.8	0.3	0.3	0.8	0.7	0.09	0.4	0.4	0.2	0.09	0.3	0.2	0.06	0.7	1.0	0.4	0.03	0.2	0.04	0.005
Q3 Sept	3.2	3.2	1.9	1.8	1.4	0.07	0.4	0.2	0.9	0.3	0.3	0.9	0.7	0.04	0.4	0.4	0.3	0.08	0.4	0.2	0.08	0.8	1.6	0.4	0.02	0.2	0.04	0.006
Non-Fund Base Income																												
2003 Dec.	7.2	7.8	4.9	4.5	2.1	0.1	0.8	0.1	1.0	0.5	1.4	3.4	1.7	0.1	0.6	2.7	0.5	0.2	0.4	0.7	0.3	1.6	2.3	0.8	0.3	0.4	0.2	0.01
2004																												
QI March	1.3	2.2	1.4	0.9	0.4	0.03	0.1	0.03	0.2	0.1	0.3	0.4	0.3	0.05	0.3	0.4	0.1	0.02	0.1	0.1	0.07	0.5	0.5	0.2	0.08	0.07	0.03	0.002
Q2 June	2.1	2.1	1.0	1.0	0.6	0.02	0.7	0.05	0.8	0.1	0.2	0.4	0.4	0.05	0.1	0.8	0.1	0.03	0.2	0.1	0.1	0.6	1.0	0.2	0.1	0.08	0.04	0.003
Q3 Sept	2.6	2.8	0.9	0.9	0.4	0.01	0.1	0.06	0.3	0.1	0.2	0.4	0.4	0.04	0.2	0.3	0.1	0.03	0.1	0.02	0.07	0.5	1.6	0.2	0.06	0.08	0.04	0.004
Admn. Expenses																												
2003 Dec.	7.8	10.1	6.6	6.6	4.2	0.2	1.0	0.3	1.4	0.5	1.1	1.8	2.2	0.4	0.7	0.8	0.7	0.3	0.6	0.4	0.3	1.8	1.8	0.9	0.4	0.4	0.2	0.04
2004																												
QI March	2.1	3.0	1.4	1.6	1.0	0.07	0.2	0.07	1.4	0.1	0.3	0.6	0.6	0.08	0.2	0.2	0.2	0.08	0.2	0.1	0.07	0.4	0.5	0.2	0.1	0.1	0.05	0.008
Q2 June	2.2	3.3	1.7	1.9	1.0	0.05	0.2	0.1	0.4	0.2	0.3	0.6	0.7	0.09	0.2	0.3	0.2	0.1	0.2	0.1	0.1	0.4	1.1	0.2	0.1	0.1	0.06	0.009
Q3 Sept	2.3	3.2	1.6	1.7	1.0	0.03	0.3	0.08	0.5	0.2	0.3	0.7	0.7	0.09	0.2	0.3	0.2	0.1	0.2	0.1	0.1	0.5	1.7	0.2	0.1	0.01	0.05	0.009
Profit(Loss)B.T																												
2003 Dec.	9.0	5.5	4.5	3.6	0.9	0.3	1.0	0.4	1.9	0.8	1.5	3.5	0.6	0.06	1.2	2.7	0.4	0.05	0.8	1.0	0.2	2.7	2.4	1.3	0.04	0.4	0.2	-0.006
2004																												
QI March	1.9	1.3	1.3	0.8	-0.2	0.06	0.2	0.1	0.5	0.3	0.3	0.3	0.2	0.01	0.4	0.5	0.1	0.007	0.3	0.2	0.05	0.6	0.4	0.3	0.02	0.1	0.02	-0.002
Q2 June	2.2	0.9	0.7	1.4	-0.7	0.05	0.9	0.1	1.1	0.2	0.2	0.5	0.4	0.05	0.3	0.9	0.1	0.01	0.3	0.1	0.06	0.9	0.8	0.3	0.02	0.1	0.007	()
Q3 Sept	3.0	1.8	1.0	0.9	1.0	0.05	0.3	0.08	0.6	0.2	0.2	0.4	0.4	0.02	0.3	0.4	0.1	0.01	0.3	0.06	0.05	0.8	1.4	0.4	0.02	0.1	0.03	()
Profit(Loss)A.T																												
2003 Dec.	4.2	4.0	2.8	2.2	0.4	0.2	0.7	0.3	1.1	0.4	1.0	2.1	0.4	-0.02	0.7	2.1	0.3	0.02	0.6	0.4	0.2	1.7	1.3	0.8	0.08	0.3	0.2	-0.006
2004																												
QI March	1.0	0.9	0.7	0.6	-0.2	0.01	0.1	0.08	0.3	0.2	0.2	0.2	0.1	0.01	0.2	0.4	0.08	0.007	0.2	0.08	0.04	0.4	0.4	0.2	0.02	0.09	0.01	-0.002
Q2 June	1.2	0.6	0.3	0.6	-0.5	0.05	0.7	0.1	0.9	0.1	0.05	0.4	0.2	0.04	0.2	0.7	0.09	0.06	0.2	0.1	0.06	0.6	0.7	0.2	0.02	0.1	0.006	()
Q3 Sept	2.0	1.6	0.5	0.7	0.6	0.05	0.1	0.06	0.3	0.1	0.1	0.2	0.2	0.04	0.2	0.2	0.07	0.009	0.2	0.06	0.04	0.5	1.9	0.3	0.02	0.08	0.02	()

[a] Excludes amalgamated/merged or newly set up Trust Bank, Crescent Commercial Bank, NIB and Dawood Bank having small assets and deposit base.
[b] Excludes Deusche Bank, Bank of Tokyo and Rupali Bank having small assets and deposit base.
* Financing under Islamic modes
() Loss of less than Rs. 1 million

Market Analysis

Market Review

November and December 2004 marked the resumption of a bullish phase in the equity markets. After a prolonged period of flat to negative movement that lasted just over 6 months, the KSE-100 Index rose 236 points (4.4%) in November 2004, and an impressive 650 points (11.7%) in December 2004. The Index opened November at 5332 points, rose to 5568 points by the month-end, and then managed to close December at 6218 points. Average daily turnover jumped sharply as well, from 227m shares in November to 451m shares in December. For the year as a whole (Jan.1-Dec.31, 2004), the Index rose 39% or 1746 points, having opened the year at 4472 points.



Top Performers

Top gainers in the two-month Nov-Dec04 period included Nishat Mills (up 52.7%) and Gadoon Textiles (50.63%). Both stocks reflected overall bullishness in the textile sector ahead of the removal of textile quotas starting January 1, 2005. While the sector will be facing new challenges in the post-quota era, textile manufacturers who have upgraded their plants are expected to come out as winners ultimately with increased sales and production.

Other strong performers included Fauji Fertilizer Bin Qasim (FFBQ), up 48% in the two-months on rumors of an expansion; Faysal Bank and Union Bank, up 43% and 42% respectively, partly on speculation but also on strong long term growth expectations; Shell Pakistan and Pakistan Oilfields, up 30% and 27% respectively on high international oil prices; and Honda Atlas Motors and Indus Motors which both gained 23% as investors recognized that valuations were attractive in the auto sector given continued growth expectations.

Primary Losers

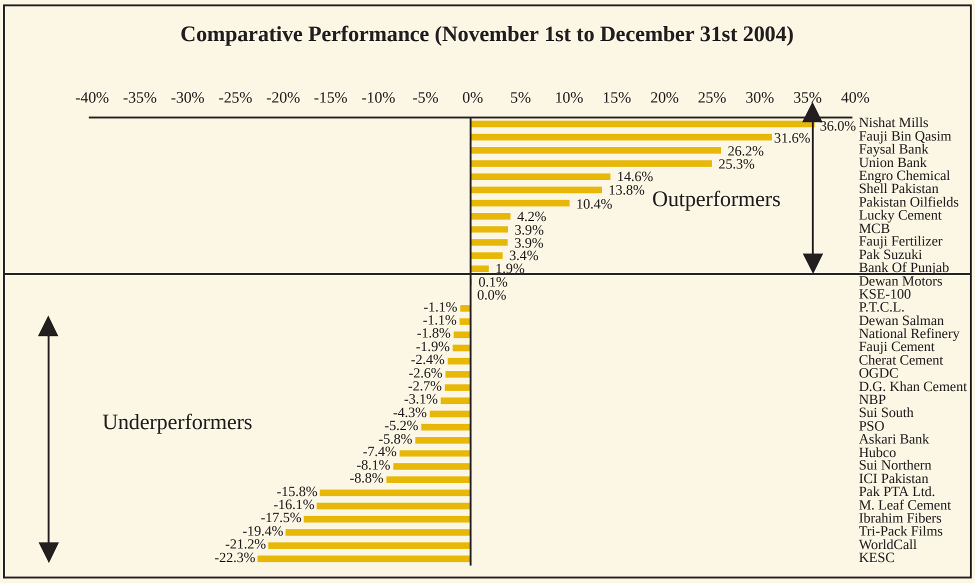
Amongst the worst performers in the Nov-Dec04 period were KESC, which shed 5.7% because its privatization did not happen as scheduled on December 6th, 2004, and also because the expected sale price once the company is privatized is far lower than the current market price. Worldcall Communications continued its lackluster performance with a 4.6% drop in share price in this period, and Tri-Pack Films also lost 2.8% in this period. The worst performer however was Meezan Bank which closed down 12.4%.

Outlook

The overall outlook is positive for the short-term. Momentum going into January 2005 was strongly positive, and this should continue at least for the first 1-2 months of the year. Our view on the market for 2005 as a whole is bullish, but there will of course be corrections along the way, mainly on technical grounds though unforeseen surprises cannot be ruled out either given the local environment and past experience.

The primary drivers for share price growth continue to be strong corporate earnings, easy liquidity, and the generally positive macroeconomic environment.

From a sectoral point of view, the outlook is positive for most sectors. International oil prices appear to have peaked for now so further upside for OMCs and E&P company shares may be limited, however, we still see opportunity in auto, banks, and the telecom sector. PTCL is slated for privatization, and as its sale date approaches, the company should see considerable gain in its share price. The same should be true for National Refinery given its upcoming sale. The cement sector should not be overlooked either. The market seems to view cements as a "has-run" sector, but cement demand growth of 24% in the last 6 months (Jul-Dec04) continues to surpass expectation, and suggests that the sector supply-demand scenario in the future may not be as difficult as naysayers project.

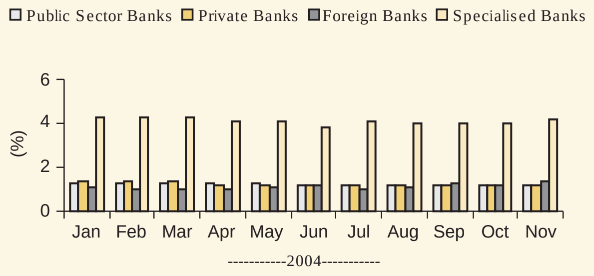


(Contributed by Taurus Securities Ltd, a subsidiary of National Bank of Pakistan)

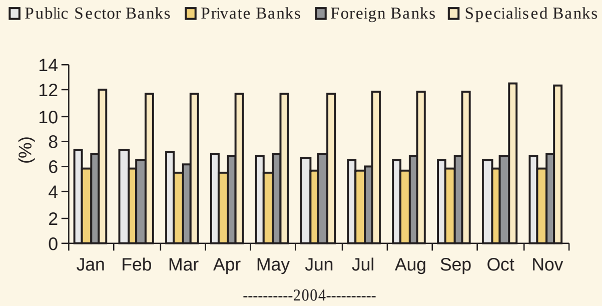
ECONOMIC BULLETIN November - December 2004

The Year 2004

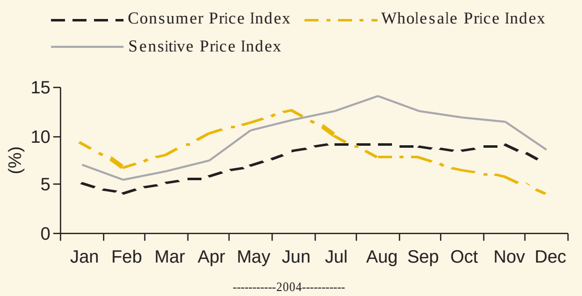
Deposit Rates
Weighted Average



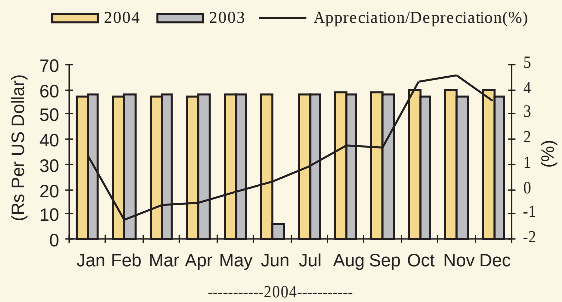
Lending Rates
Weighted Average



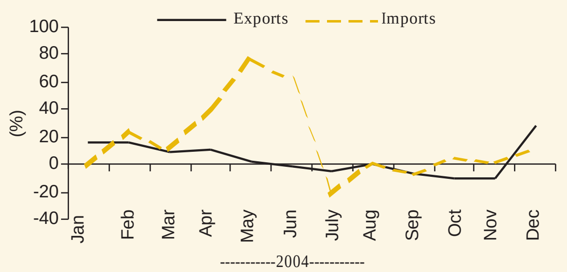
Inflation Indicators



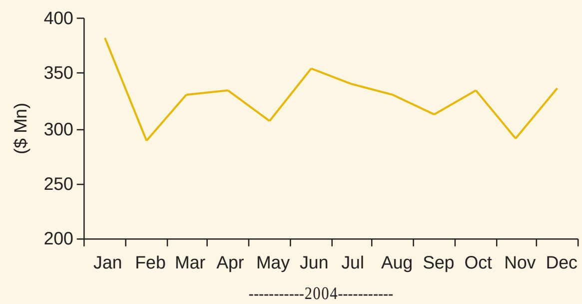
Currency Exchange Rate



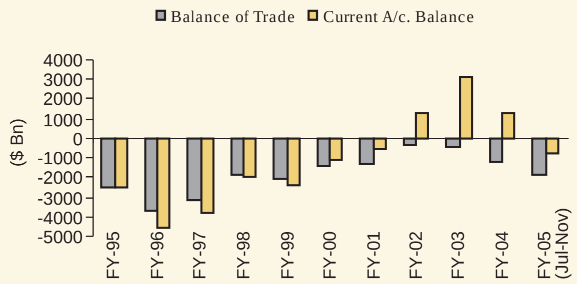
Exports & Imports
Annual Growth Trend



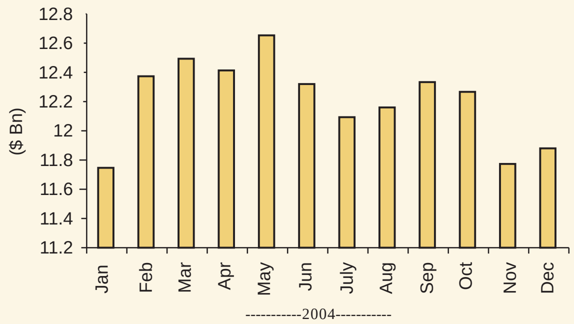
Workers Remittances



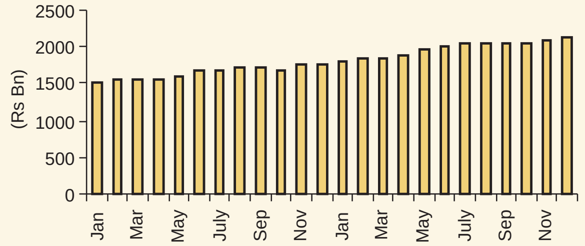
Trade & Payments Deficit



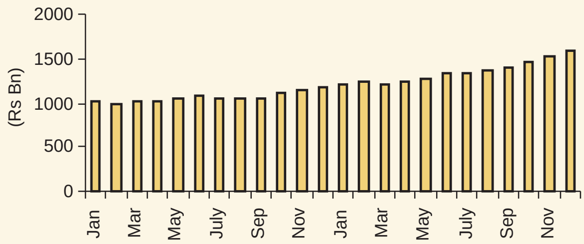
Foreign Exchange Reserves



Deposits of Scheduled Banks

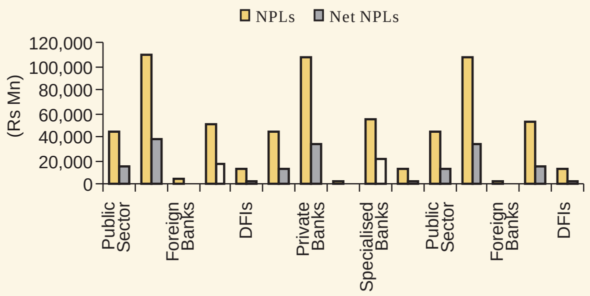


Total Advances of Scheduled Banks

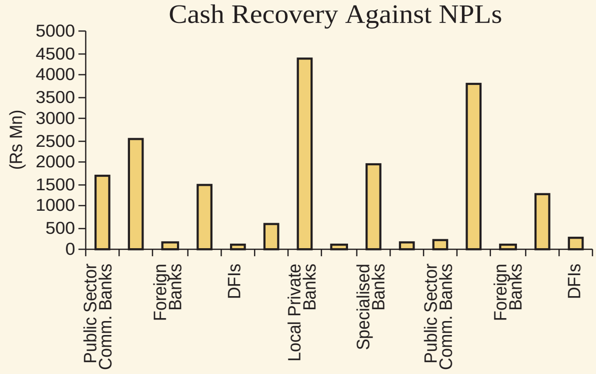


Banks' Non Performing Loans

(Domestic+Overseas Operations)

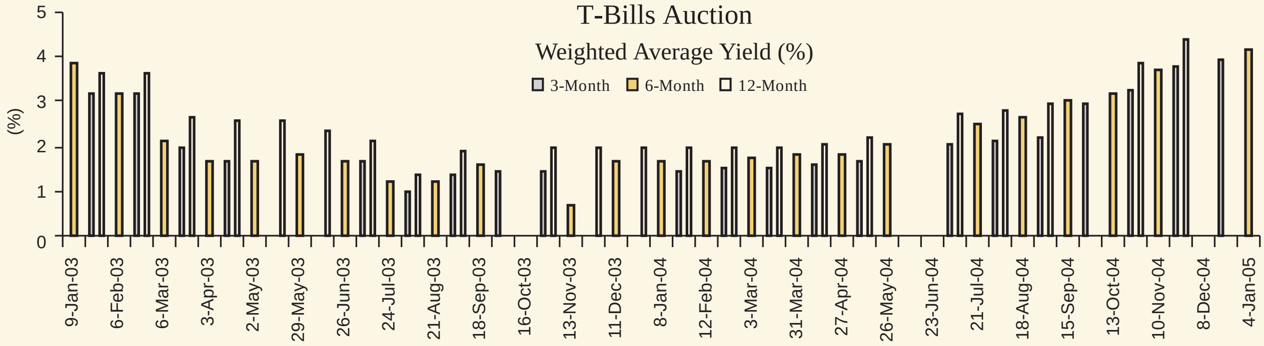


Cash Recovery Against NPLs

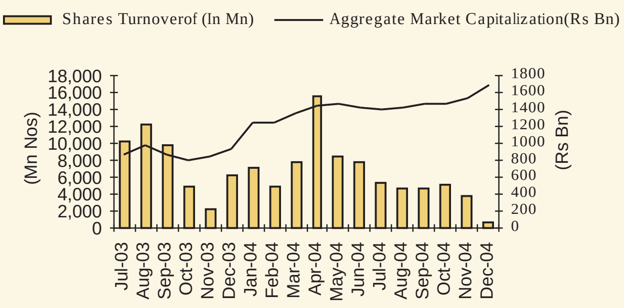


T-Bills Auction

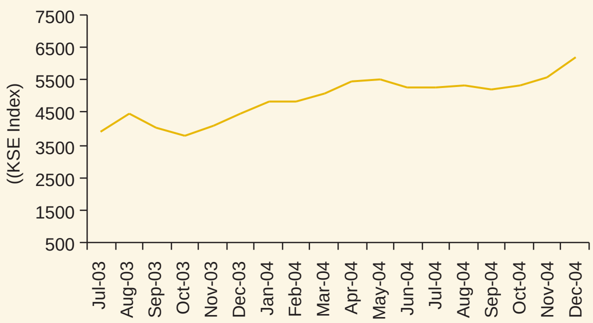
Weighted Average Yield (%)



Share Business/Market Capitalisation



Karachi 100 Index



Book Reviews

We would like to introduce some of the new books available in the market on Pakistan's economy, which would be of interest to our readers.

A. *Dollars, Debt and Deficits, by Dr. Ishrat Hussain*

Dr. Ishrat Husain, Governor State Bank of Pakistan has written a number of books. This publication is a compilation of articles that were published until 1999 and also comprise his speeches, papers and addresses delivered as Governor, of the Central Bank. As such it covers a range of subjects, tackling some of the fundamental issues, focusing on factors that have a bearing on long term development, analyzing the problems in an objective and dispassionate way to identify pragmatic and workable solutions and providing hard choices to the difficult issues.

In the second part of the Book, the author has adopted a more realistic approach to the problems confronting Pakistan. In his preface, he writes "in practice, the real world does not operate according to the simple analysis of economic logic and there are many complexities and intricacies involved in arriving at a decision."

Some of the topics covered in this section are of interest to the readers given their growing importance in the economy. This includes the economic reforms and challenges confronting the economy, the SME sector, problem of poverty, the need for micro-finance, the banking sector reforms, the changes introduced in the State Bank, the measures to be taken to start improving our social and human development indicators, the essential ingredients to develop a fair, efficient and equitable tax system in the country, and an interesting article on why perceptions about Pakistan economy differ.

The book is a great addition to the literature available on Pakistan economy.

B. *Social Development in Pakistan*
Combating Poverty:
Is Growth Sufficient – Annual Review 2004
Social Policy and Development Centre

Social Policy and Development Centre is a private sector research organization that undertakes policy relevant research on social sector development. Over the last ten years it has highlighted the problems of social underdevelopment and inequality and poverty.

The Annual Review – 2004, outlines a strategy for poverty reduction. Poverty reduction cannot be achieved through growth alone, but requires a measure of equity as well. The strategy outlined is built upon three pillars: accelerated GDP growth, improved asset/income distribution; and enhanced human/social development. It suggests a policy framework whereby accelerated growth and rapid poverty reduction can be rendered complimentary and feasible in the medium term.

C. *Management Text & Cases – 2005, by Prof. Dr. Khawaja Amjad Saeed*

Dr. Khawaja Amjad Saeed, Principal, Hailey College of Banking & Finance University of Punjab, Lahore has to his credit quite a number of books; in diversified areas, the economy of Pakistan, Auditing, Management, Mercantile & Industrial Laws.

The contents of the above mentioned book recently published, contains lucid analysis of the basic concepts of management, a section which deals with contemporary issues in human resource management and development, knowledge management, the rise of reengineering, motivation etc., while the third section has selected case studies on contemporary issues in Management. These cases (12) have been authored by South Asian scholars and edited by the author. They cover such themes as decision-making, Personnel Management, Industrial Relations, Strategic Management etc.

D. *Financial Management in Pakistan*
by Javed Ansari, Muhammad Naeem, Jamal Zuibairi
Oxford University Press

A book on financial management process in Pakistan. It explains financial management theories and practices in the context of Pakistani laws, business environment and institutions. It gives an insight into understanding financial management as practiced in Pakistan.

The first part of the book discusses the capitalist financial system, part two is about the tools, techniques and methods used in financial management and the last section is about financial management practices, with case studies on capital budgeting, capital structuring, working capital management and leasing.

As forecasting is an integral part of the planning process, there is a chapter on Financial Planning & Forecasting, which discusses cash flow forecasting and the forecasting of financial statement, with a brief introduction to Financial Planning models.

E. *Money & Banking in Pakistan*
Fifth Edition
by S. A. Meenai, Revised and Expanded by Javed A. Ansari

A comprehensive book on money and banking, detailing banking sector developments in Pakistan during the period 1947-2003. The fifth edition has been extensively revised and updated.

Part one deals with monetary theory and policy, presenting the major schools of monetary policy and assessing their policy recommendations in the Pakistani context; with a chapter identifying what monetary policy can and cannot do.

The second part of the book gives an historical background to the development of the banking sector, the institutional structure of the country, the growth of the financial markets in Pakistan and a period analysis of the monetary policy pursued. It also includes a review of several empirical studies on monetary and financial sector development in Pakistan.

F. *World Development Report – 2005*

This year's World Development Report has as its central theme creating a 'Better Investment Climate for Everyone'. It is only if the environment in which firms and entrepreneurs, farmers and small and micro-enterprises, large manufacturing units and multinationals operate is conducive and offers opportunities for investment can each sector contribute towards development and poverty reduction. Perhaps it may be considered as one of the central challenges of development.

The Report draws four major conclusions. First, the objective should be to create an investment climate that benefits all; firms of all sizes and types so that each makes a contribution to growth and poverty reduction. Second, efforts to improve the investment climate need to go beyond just reducing business costs. Third, the Report emphasizes that progress requires more than changes in formal policies. The Governments need to bridge the gap between policies and their implementations. The Governments have to build credibility and develop public trust, to ensure their policy interventions are crafted to local conditions. And finally the Report reviews strategies for tackling such a broad agenda. Everything cannot be done at once. However, governments have to address the important constraints so that confidence is built to invest and sustain a process of ongoing improvements.

Key Economic Indicators

Economy Size & Growth		2000-01	2001-02	2002-03	2003-04
GNP - Market Prices	Rs. bn	4108.2	4425.4	4973.1	5576.3
GDP - Market Prices	Rs. bn	4162.6	4401.7	4821.3	5458.1
Per Capita Income	Market Prices Rs.	29269	30910	34074	37495
	Market Prices US$	501	503	582	652
Growth					
GDP	%	1.8	3.1	5.1	6.4
Agriculture	%	(-)2.2	0.1	4.1	2.6
Manufacturing	%	9.3	4.5	6.9	13.4
Wholesale & Retail trade	%	4.5	2.8	5.9	8.0
Rate of Inflation	%				
Consumer Price Index**		3.6	3.5	3.1	4.2†
Wholesale Price Index		6.2	2.1	5.6	7.5†
Balance of Payment	$mn				
Exports (f.o.b.)		8933	9140	10889	9175‡
Imports (f.o.b.)		10202	9434	11333	9932‡
Trade Balance		(-)1269	(-)294	(-)444	(-)757‡
Services Account (Net)		(-)3142	(-)2617	(-)2128	(-)2260‡
Private Transfers (Net)		3898	4249	5737	4386‡
Current Account Balance		(-)513	1338	3165	1369‡
Fiscal Balance	% of GDP				
Total Revenue (Net)		13.3	14.2	15.0	14.3
Total Expenditure		17.2	18.8	18.6	17.5
Overall Defict		4.3	4.3	3.7	3.3
Domestic & Foreign Debt					
Domestic Debt	Rs. bn	1799.2	1757.6	1879.2	2028.4
As % GDP		43.2	39.9	39.0	37.2†
Total External Debt & Liabilities	$bn	37.139	36.532	35.474	35.846†
as % GDP		52.1	51.0	43.0	37.8†
as% of Foreign Exchange Earnings		259.8	237.0	181.1	168.7
Investment & Savings	% of GDP				
Gross Investment		17.2	16.8	16.7	18.1
Gross Fixed Investment		15.8	15.5	14.8	16.4
National Savings		16.5	18.6	20.6	19.8
Domestic Savings		17.8	18.1	17.4	17.6
Foreign Investment	$mn	182	475.0	820.1	629.0
Portfolio		(-)140	(-)10	22.1	(-)131.3
Direct		322	485	798.0	760.4
Monetary Aggregates	%				
M_1		3.0	15.2	26.2	17.5
M_2		9.0	15.4	18.0	12.3
Literacy Rate	%	49.0	50.5	51.6	54.0
Foreign Exchange Reserves^	$mn	3220	6432	10719	12511†
Exchange Rate++	Rs./$	58.4378	61.4258	58.4995	57.5378
Stock Market Growth Rate	%				
SBP General Index of Share Prices**		(-)7.9	10.1	91.9	61.9†
Aggregate Market Capitalisation		(-)13.4	20.0	83.1	96.7†

* Constant Factor Cost of 1999-2000 ** Base 2000-01

† July-May ‡ July-March

^ Excludes FE 13/CRR and includes Indian pending transfers, new FCA and Trade Nostro.

++ Average during the year.

M_1 Outstanding stock of currency in circulation+demand deposits of schedule banks+other deposits with SBP.

M_2 M_1 +outstanding stock of time deposits+outstanding stock of FRCDs.

Source: Economic Survey 2003-04