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Editor's Corner

Dear readers,

In Pakistan, general elections have been held and new elected leaders are working out strategies to form the new government.

The government has in the past three years withstood difficult times, initiated the beginnings of economic revival with farsighted reforms which brought stability to the economy. However, continuity of reforms is absolutely essential and more needs to be done.

Fiscal policy has centred around revenue mobilisation and macroeconomic policy has been directed towards stabilisation, at times, at the cost of growth.

Although the government has launched a multifaceted poverty alleviation programme, unemployment has caused deprivation and hardship. While the upper income groups can afford the best of healthcare, housing and education, it is the poor who are excluded on account of their lack of affordability and access.

The new government will have to objectively assess the direction of the fiscal and macroeconomic policies, and the need for the focus to shift from revenue mobilisation to current expenditure reduction, with enhancement in development expenditure. This is essential to create investment and for growth in employment, income and purchasing power. Ultimately in addition to the programmes already launched by the government, this will enable poverty reduction.

The elected government will have to establish its development priorities. Should it go for capital intensive mega projects or invest in high value added projects which generate employment over an extended period of time. Are we going to see any substantial change, by implementing conducive policies, strengthening institutional structures, efficient targeting and broad based coverage of current social safety net programmes?

When people are provided with economic opportunities, law and order is expected to improve. If the jobless youth has employment, has earnings, whereby basic needs are met, than one expects anti-social activities that one witnesses, reduced to a great extent.

It is a challenge for the elected government to develop an appropriate strategy to stimulate investment and accelerate economic growth. The withdrawing of Indian troops from the borders should help ease tensions, reduce expenditure on defence, thereby creating fiscal space for increasing development expenditure for pump priming the economy and thereby improving the investment climate.

As domestic investment picks up, because of good policies, improved law and order, foreign investment would follow and industrialisation should pick up. Multinationals have an advantage in this country, for not only is cheap labour available, but there are nearby markets in Afghanistan and the CIS countries.

Not only has the government to revive the major industries operating at below capacity but focus on the development of small cottage industries if an all round prosperity is to be made possible.

Pakistan has in the recent past, undertaken an ambitious programme of restructuring. It has made good progress on debt restructuring and building up its reserves. Privatisation of United Bank Ltd has been completed successfully. The government has been able to offload an additional 5% of NBP shares at a premium and the subscription was heavily oversubscribed as before. This demonstrates the faith of Pakistani investors in the government policies being pursued. While privatisation is being followed by the government, there is some opposition by vested interest in these organizations. One hopes that the process would be carried forward by the ensuing government.

A few words on Islamic Banking. Given the present structure, the possibility of having a totally interest free economy could be counterproductive in the short to medium term unless substantive changes are introduced in the finance and banking sector. Further, interest free banking would have to be developed for which specialised skills have to be acquired. To practically implement interest free banking would take time and skill development. If the debate resumes, the foreign investor would again adopt a wait and see approach and we may see some setback in inflows of foreign investment.

Let us be optimistic about the future. The last three years have in an overall context been very positive for the economy. We are confident that the new government will build on this foundation.

Ayesha Mahmud

Abstract of the Bulletin

Performance of Major Pakistani Commercial Banks – 2001

- National Bank of Pakistan, Habib Bank Ltd, Muslim Commercial Bank, United Bank Ltd and Allied Bank Ltd dominate Pakistan's banking industry.
- In the year 2001, with the exception of United Bank Ltd, the others have shown profits. National Bank of Pakistan recorded the highest profit of Rs.3 billion (BT).
- While deposits grew by 10% in the year, advances slowed down. National Bank continues to enjoy the highest deposit base.
- Reforms initiated have helped improve banking operations. Some key ratios have improved, cost of funds and intermediation cost has declined. Net interest margin for major banks has risen.

Corporate Governance – Recent Initiatives

- Recent corporate failures in the US, have brought into focus corporate governance practices; the need to ensure accounting transparency, disclosure methods, codes of ethics, risk management practices, role of regulators and auditors.
- In the recent past, the New York Stock Exchange, Nasdaq, other stock markets in the world, companies like Mazda, Fujitsu among others, international banks, governments have felt the need for new rules so to strengthen governance practices.
- In Pakistan, the Securities and Exchange Commission of Pakistan has introduced new principles for listed companies, thereby ensuring good corporate governance.

IMF-World Bank Annual Meeting

- The International Monetary Fund and the World Bank held their 57th annual meeting in Washington.
- The meeting covered a wide range of issues which included among others, poverty reduction, debt burden, banking restructuring, corporate governance, and the ways these institutions could continue to assist members in strengthening their economies.
- There is a process of change at the IMF, so to strengthen IMF's capacities with the needs of the global economy.

Banking and Finance

- Scheduled banks deposit growth outpaced the rise in advances, as credit demand remained sluggish.
- Scheduled banks investment in central government securities showed a substantial jump in October. Meanwhile, approved foreign exchange also recorded marked increase.
- During the month of October, the management of United Bank Ltd was taken over by the Consortium of Abu Dhabi Group and Bestway Group. Second offer for sale of shares of National Bank of Pakistan was heavily oversubscribed. Last year, the government had offloaded 10% shares of NBP.

Trade

- Exports have grown significantly (14%) in the first quarter of FY03. Growth in imports was however, slower (11%).
- Trade deficit narrowed substantially to $ 201 million.

Market Analysis

- The current Bull Run is showing no signs of taking a breather. The market continued its up trend in the month of September and October. Despite making a two-day fall immediately after the October elections, the market made a strong comeback to clearly breach the 2100 level by the end of the following week, an eight-year high. This reflects the underlying strength of the bull market, which began a year ago and shows no sign of stopping.
- This month we discuss how the market's sustained bull-run over the last 12 months is more due to improved fundamentals which is reflected through increased investor confidence, rather than speculation alone.

Performance of Major Pakistani Commercial Banks - 2001

NCBs dominate the banking sector

Pakistan's banking sector is dominated by National Bank of Pakistan (NBP), Habib Bank Ltd (HBL), United Bank Ltd (UBL), Muslim Commercial Bank (MCB), Allied Bank Ltd (ABL). The analysis also includes First Women Bank Ltd (FWB), a small bank in the public sector with a special focus on women. These banks have an extensive network of 5800 branches and provide employment to over 60,000 workforce.

The initiation of financial liberalization in early 1990s followed by wide ranging banking reforms, permitting private banks to operate, resulted in increased competition amongst commercial banks. Among these banks, MCB, ABL and more recently UBL[1] have been privatized, while NBP, HBL and FWB are in the public sector. NBP has offloaded 15% shares in the market. These banks form the largest group and their performance significantly affects overall indicators of the banking sector.

Over staffing, growing number of non-profitable branches and inefficiencies in nationalised commercial banks[2] (NCBs) led to the problems of large non performing loans, high operating costs, huge losses and eroding capital base, thereby adversely affecting performance of banking sector. With growing competition from private and foreign banks, NCBs were finding it difficult to maintain their market share in deposits, advances and investments.

NCBs staff size shrinking

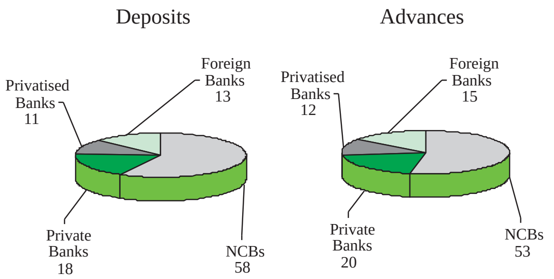
Consequently, they initiated restructuring/ reorganization programme to improve efficiency and compete with private and foreign banks. Under the golden handshake scheme, number of staff over the past three years has been reduced by 15%, with NCBs accounting for 17% reduction. Similarly, number of branches has also been reduced by closing loss making and non-profitable branches. NCBs have closed 730 such branches in the past three years. Though relative size of NCBs has declined, the group still holds a major share in the market.

An analysis of balance sheets of these banks[3] reveals that despite significant rise in pre-tax profit of NBP, HBL, MCB and FWB in 2001 the overall pre-tax profit for the group declined by nearly 66%. This was mainly on account of a huge loss incurred by UBL due to a written off amount of Rs.7.2 billion pertaining to long overdue overseas loans, which was not paid by the Government of Pakistan under an earlier arrangement.

Highest profit at NBP

In the year, NBP emerged as the highest pre-tax profit earner, as revenue growth and prudent cost management led to 192% growth in its profit (BT). HBL's pre-tax profit was the second highest, while MCB maintained a healthy growth, primarily due to fund based activities and efficient assets and liability management. FWB, with only 38 branches and 480 employees, posted a profit. Though small in absolute terms, it recorded a massive growth of over 340% over the year.

Percentage Share in



Income Statement 2001

(Rs. Mn)

Banks	Net Interest Income	Non Fund Income	Total Revenue	Operating Expenses	Provisions/ Differed Costs/ Unusual Items	Profit/(Loss) (B.T)
NBP	12413	4502	16915	9,058	4842	3015
HBL	11519	5327	16846	11,985	2637	2224
UBL	5134	2902	8036	5,301	8463	(5728)
MCB	9488	2201	11689	7,372	2216	2101
FWB	242	25	267	144	7	116
Total	**38796**	**14957**	**53753**	**33,860**	**18158**	**1735**
NCBs	29308	12756	42064	26,488	15942	(366)

[1] UBL's management has recently been handed over to a consortium of Abu Dhabi Group of UAE and Bestway Holdings Ltd of UK under the government of Pakistan privatization programme.

[2] Excludes MCB & ABL.

[3] The study excludes ABL as the bank has not yet released its balance sheets for 2000 and 2001. Analysis of NBP, HBL, UBL, MCB and FWB is based on their annual accounts as of 31st December 2001.

Revenue shows strong growth

Revenue growth of major banks remained strong at 18% in 2001. Almost one third of it was contributed by NBP alone. NBP recorded the highest growth (32%), a sharp turnaround from preceding year's decline of 10%. While MCB also showed double digit growth, revenue more than halved at HBL and UBL suffered a decline of 3% in sharp contrast to 51% growth a year earlier.

Net interest income is the major source of revenue growth. It accounted for 72% of total revenue and 44% of total interest income in 2001. Revenue growth in major banks was entirely on account of 33.5% rise in net interest income. Major portion of this growth was contributed by the NCBs. Despite a downward trend in interest rates, NBP recorded a significant rise in net interest income (41%), the highest among the larger banks and in sharp contrast to preceding year's fall.

Interest expense falls

Due to the downward trend in interest rates, interest expense continued to fall for the second consecutive year, showing a 7.3% decline. Highest decrease was recorded by HBL, followed by NBP and UBL. MCB was the only bank to record a rise. It also recorded the highest growth in interest income compared to a 10% decline a earlier year. Growth in interest income halved at HBL, while UBL recorded a decline after 16.6% increase the previous year. In volume terms, NBP has the highest share in interest income and interest expense.

Non-interest income falls

The deregulation of interest rates in recent years has narrowed net interest margin and caused banks to rely more on non-fund based income (non-interest income). The analysis reveals that non interest income of banks under review declined in 2001. The decline was to the tune of 9%, in sharp contrast to an 18% growth recorded a year earlier. Highest decline was recorded by MCB. NBP was the only bank to record a growth of 12%. In volume terms, non-interest income was the highest at HBL, or more than one third of total income of major banks. Non-interest income constituted 28% of total revenue.

Staff cost high at HBL

Under the restructuring plans, banks have rationalized their workforce which has helped reduce staff costs. In 2001, banks were able to cut their staff costs by 1.6% against a 3.4% growth in 2000. NCBs managed to reduce their cost by 2.6%. There was a massive cut of 22% at UBL, while NBP recorded an increase. Despite a decline, HBL's staff cost continues to be the highest in the banking sector.

Staff cost per branch recorded an increase. All banks with the exception of UBL, contributed to this rise. While the highest increase was contributed by MCB, HBL has the highest staff cost per branch amongst the larger banks.

Staff / Staff Costs

Banks	Staff (Nos)		Branches (Nos)		Staff Cost (Rs. Mn)		Staff Cost Per Branch (Rs. Mn)	
	2000	2001	2000	2001	2000	2001	2000	2001
NBP	15351	15163	1228	1245	5771	6444	4.70	5.10
HBL	22779	14352	1755	1516	8554	8179	4.87	5.40
UBL	11879	8998	1390	1117	3491	2708	2.51	2.42
MCB	12133	11614	1210	1061	5170	5261	4.27	4.96
FWB	484	484	38	38	61	82	1.61	2.16
Total	**62626**	**55611**	**5621**	**4977**	**23046**	**22674**	**4.10**	**4.56**
NCBs	50493	43997	4411	3916	17876	17413	4.05	4.45

Administrative expenses showed a marginal decline, with NCBs contributing 1% cut, mainly attributable to reduction in such expenses by UBL (15%) and HBL (1.5%). NBP, MCB and FWB registered increases under this head. HBL continues to incur highest administrative expense amongst major banks.

1% cut in admn expense at NCBs

While reorganization and restructuring of banks have reduced the number of employees and branches in NCBs, such expenses have gone up due to voluntary separation schemes offered by major banks, among other factors. Administrative expenses still account for 63% of operating expenses (including provisions) of major banks. The ratio is significantly high for FWB, HBL and MCB. It is low for UBL (34%).

Rising trend in deposits

Total deposits of major banks during the year increased by 10%, with NCBs contributing 9% growth. Rising trend was observed in the deposits of all banks. Though MCB recorded the highest growth amongst larger banks, NBP continues to enjoy highest deposit base. FWB has the lowest deposits base. NCBs account for 84% of total deposits of major banks and nearly 69% of all scheduled banks.

Deposit structure showing a shift

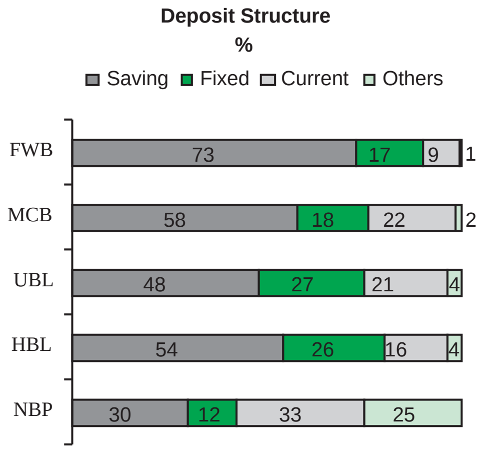
Deposit structure reveals that almost the entire increase in total deposits is attributable to a rise in current and savings deposits. The composition shows that 45% of total deposits constitute savings deposits, 23% term deposits and the remaining 32% are current account and other deposits.

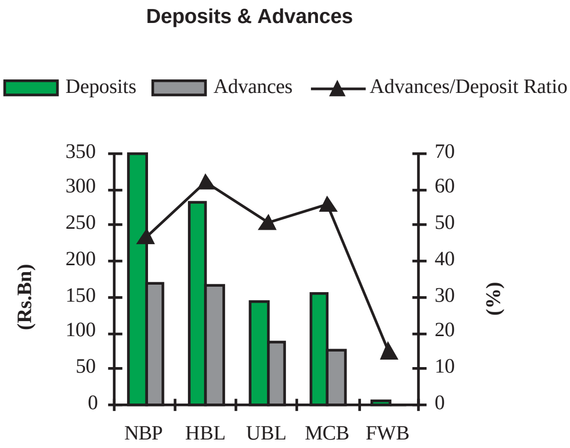
In 2001, while MCB recorded the highest growth in saving deposits, NBP, HBL and UBL recorded a decelerating growth over 2000. Among the larger banks, MCB has the highest saving deposits to total deposit ratio (58%) followed by HBL (54%). UBL enjoys the largest share in fixed deposits (27%).

Current account deposits showed a double digit growth, as all banks recorded increases. Highest growth was recorded by NBP. A breakup of NBP's deposits show current deposits account for (33%), savings deposits (30%), term deposits (12%) and other deposits (25%).

Growth in advances slows

Advances of major banks showed a slower growth of 6% in 2001, three times less than in 2000. Growth in advances at NCBs exceeded that of major banks by 4 basis points. FWB recorded the highest increase (38%) but its advances portfolio is very small. Amongst the larger banks, NBP posted the highest growth while HBL and MCB recorded declines.





Invest-ments fall

Investment portfolio of major banks fell by 1.3%, with NCBs showing a decline of 8.6%, mainly due to a fall by UBL, HBL and NBP. Despite the decline, NBP continued to enjoy the highest investment portfolio. Among the larger banks, MCB recorded the highest increase (29%) while UBL showed the largest decline (17%). FWB with a small investment base recorded a 220% rise.

Key Indicators

(Rs. Bn)

Banks	Advances 2000	Advances 2001	Investments 2000	Investments 2001	Deposits 2000	Deposits 2001	Assets 2000	Assets 2001	Equity 2000	Equity 2001
NBP	140.3	170.3	72.6	71.8	316.5	349.6	371.6	415.1	11.4	12.0
HBL	174.9	167.2	68.1	57.8	266.1	283.4	328.6	333.7	8.8	9.5
UBL	74.2	88.4	33.8	28.1	128.9	142.6	161.8	168.6	6.8	(0.8)
MCB	86.4	76.6	43.1	55.4	136.0	154.6	174.7	187.1	4.5	5.0
FWB	0.6	0.80	0.7	2.4	3.4	6.2	3.9	7.2	0.1	0.2
Total	**476.4**	**503.3**	**218.3**	**215.5**	**850.9**	**936.4**	**1040.6**	**1111.7**	**31.6**	**26.7**
NCBs	390.0	426.7	175.2	-160.1	714.9	781.8	865.9	924.6	27.1	21.7

Source: Annual Reports of various banks

NCBs account for bulk of NPLs

Major banks witnessed substantial recovery of non-performing loans (NPLs) though these still account for a third of their gross advances. Non-performing loans of NCBs accounted for 91% of major banks NPLs and 26% of gross advances in 2001. Total NPLs grew by 5.1%, mainly attributable to a significant increase in NBP's NPLs during 2001. This is on account of addition of Rs.13.6 billion non-performing advances of former National Development Finance Corporation which has been amalgamated with NBP. HBL and MCB have also recorded increase in their non- performing loans. However, UBL recorded 22% decline in such loans. HBL continues to have the highest NPLs amongst major banks.

Higher provisions made by NCBs

In 2001, major banks increased provisioning for NPLs by 16%, with the exception of UBL, which made 19% less provisioning. Though NBP recorded the highest growth (42%), such provisions were highest in absolute terms of HBL.

Assets of major banks increased by 7%, largely because of a substantial rise at NBP and FWB.

Large asset/ equity base of NBP

NBP which holds nearly 40% of assets, contributed the highest growth amongst larger banks. FWB with the smallest asset base recorded a growth of 87%. Equity of UBL went into negative in 2001, which resulted in 15% decline in total equity. Among other larger banks, NBP, HBL and MCB recorded slower growth. Highest growth was 11.2% at MCB. However, NBP continues to enjoy highest shareholders' equity, which is 45% of all major banks.

Non Performing Loans

(Rs. Bn)

Banks	Gross Advances 2000	Gross Advances 2001	Non-Performing Loans 2000	Non-Performing Loans 2001	Provisions 2000	Provisions 2001	Net NPLs 2000	Net NPLs 2001
NBP	158.6	196.3	30.3	44.3	18.3	26.0	12.0	18.2
HBL	204.7	199.4	54.0	56.2	29.9	32.2	24.2	24.1
UBL	99.3	108.7	38.1	32.2	25.1	20.4	13.0	11.8
MCB	91.0	82.8	12.4	13.4	4.6	6.3	7.8	7.2
FWB	0.6	0.8	0.1	0.1	0.02	0.03	0.1	0.09
Total	**554.2**	**588.0**	**134.9**	**146.2**	**77.9**	**84.9**	**57.1**	**61.4**
NCBs	463.2	505.2	122.5	132.8	73.3	78.6	49.3	54.2

Source: Annual Reports of various banks

Major banks financial health improves

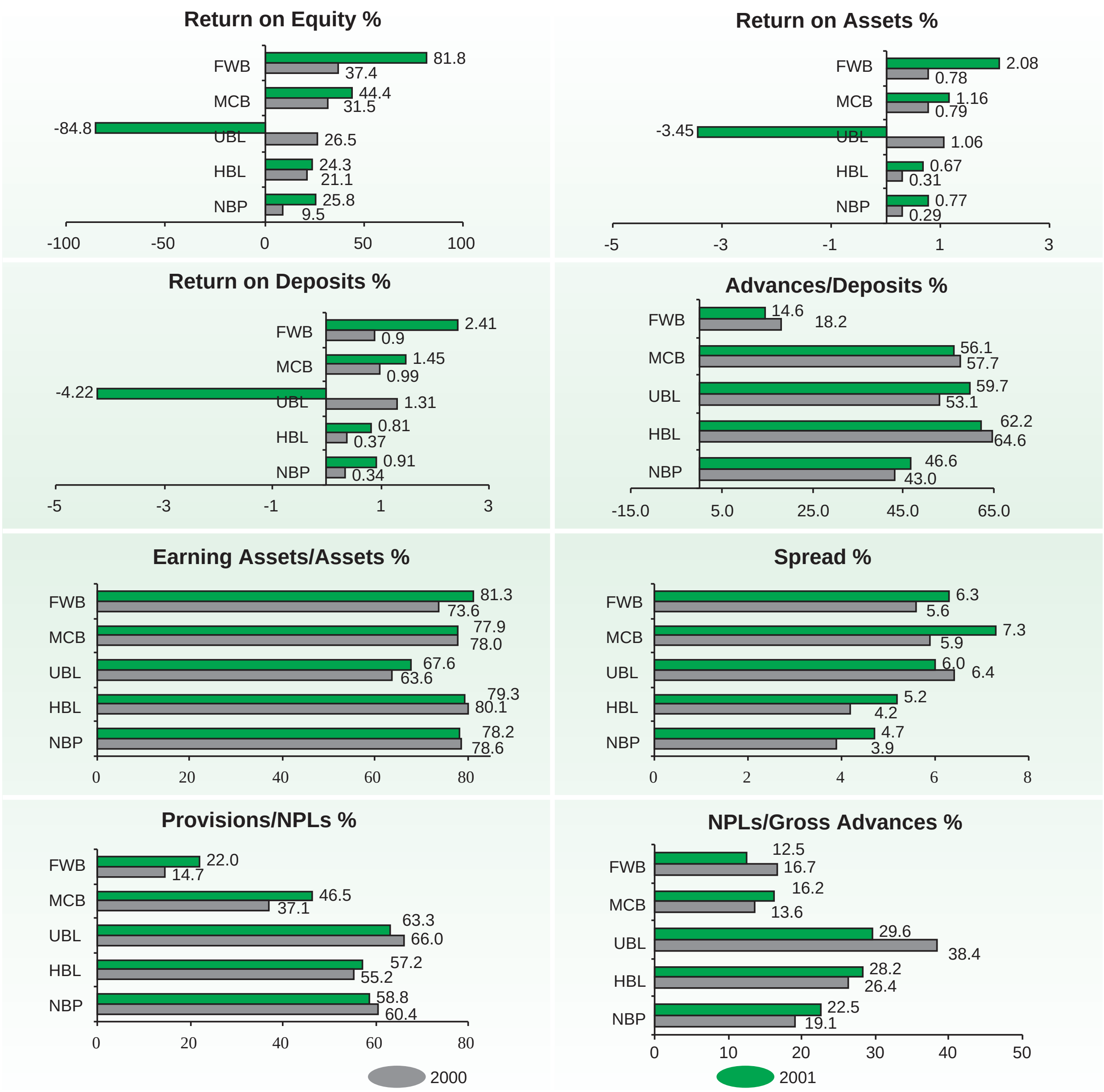
Ratio analysis reflect improved financial health of major banks in 2001. In the year these banks, on a cumulative basis, managed to cut their cost of funds to 5% down 100 basis points over 2000. FWB was the only bank amongst the NCBs to record an increase. UBL has the lowest cost of funds (4.3%) and its intermediation cost has also declined over the year. Though major banks were able to cut their intermediation cost to 3.7%, it was still higher than the international standard. While NBP's intermediation cost (2.6%) remained unchanged over last year, it is lowest amongst the major banks. The ratio was highest for MCB (5.0%).

Selected Ratios

(%)

Banks	Cost of Funds 2000	Cost of Funds 2001	Intermediation Cost 2000	Intermediation Cost 2001	Net Interest Margin 2000	Net Interest Margin 2001	Pre-tax Margin 2000	Pre-tax Margin 2001
NBP	6.6	5.5	2.6	2.6	3.1	4.0	3.1	8.4
HBL	6.0	5.1	4.7	4.3	3.3	4.4	3.0	6.9
UBL	4.9	4.3	4.3	3.4	4.7	4.6	10.7	-39.8
MCB	5.0	4.8	5.3	5.0	5.3	6.7	7.8	10.9
FWB	4.5	6.5	3.8	2.9	4.4	5.4	9.3	19.2
Total	**5.9**	**5.1**	**4.0**	**3.7**	**3.8**	**4.7**	**5.1**	**1.7**
NCBs	6.0	5.1	3.7	3.4	3.5	4.3	4.5	-0.4

Major Banks Performance Ratios



Rise in net interest margin

Net interest margin (NIM) increased in 2001. It was the highest for MCB (6.7%) and lowest for NBP (4%). NIM ratio for major banks was 4.7%, and slightly lower for NCBs (4.3%).

Pre-tax margin was a negative 39.8% for UBL on account of loss incurred in 2001. Due to negative pre-tax margin of UBL, the ratio for major banks fell from 5.1% to only 1.7%, with NCBs contributing negative profit margin.

Profitability ratios improve

Profitability ratios indicate that except for UBL, which recorded negative return on equity (RoE), return on assets (RoA) and return on deposits (RoD) in 2001, these ratios rose for all other banks in the group. FWB recorded the highest RoE (81.8%) followed by MCB (44.4%). The ratio was the lowest for HBL (24.3%). Despite an increase in RoA, the ratio for NBP and HBL remained below 1%, it was the highest for FWB (2.1%). Similar pattern is reflected by RoD ratio of major banks. The ratio was the highest at 2.4% for FWB and lowest at 0.7% for HBL.

Advances to deposits ratio highest at HBL

Liquidity ratio reflects that only HBL was able to record advances to deposit ratio of above 60%, for others the ratio ranged between 14.6% to 56.1%. It was the lowest at FWB. Investment deposit ratio of NBP, HBL and UBL declined, while it increased for the other two banks.

Equity deposit ratio highest at NBP

Of the debt management ratios, there is an increase in equity to deposit ratio of HBL, MCB and FWB, while it fell for UBL and was slightly lower for NBP. Despite the decline, NBP recorded the highest ratio (3.5%) amongst the major banks. Due to negative equity of UBL, where the ratio was the lowest, the bank's equity to liabilities ratio also went into negative in 2001 from a high of 4.4% in 2000. The ratio increased slightly for HBL, MCB and FWB and fell for NBP. Liabilities to assets ratio remained above 90% for all major banks.

In the year 2001 it recorded a marginal decline for MCB and FWB, while it increased for NBP and UBL.

Asset quality shows little change

Asset quality as measured by earning assets to total assets ratio reveals slight improvement for UBL and FWB, while it declined for MCB, HBL and marginally for NBP. The ratio ranges between 67.6% for UBL to 81% for FWB. Non-performing loans to gross advances ratio remains high for all major banks, reaching a high of 84.5% for UBL, while it was the lowest at 14.2% for FWB. Net NPLs to advances ratio, on the other hand, grew for all major banks except FWB. It was the lowest (9%) for MCB and highest (14.4%) for HBL.

The ratio of provisions to non-performing loans increased for HBL, MCB and FWB but declined for NBP and UBL. It is still the highest (63.3%) for UBL. The ratio of provisions to performing advances also remained high for UBL, even though it dropped over a year earlier. Amongst other major banks, NBP, HBL and MCB recorded increase in the ratio, while it fell for FWB. The ratio was the lowest for FWB (4%). Ratio analysis further reveals that only FWB managed to achieve an equity plus provision to non-performing loans ratio of greater than 1.

Management soundness ratios

The ratio pertaining to management soundness reveals that operating expense to income ratio increased for NBP and MCB but declined for the other three banks. It remained the highest for HBL (37%) and MCB (38%) and lowest for FWB (24%). Staff cost per branch has also increased for all major banks, except for UBL, which recorded a decline. HBL incurred the highest staff cost per branch, lowest being of FWB. Expenditure to income ratio for major banks continues to be high. The ratio exceeds 100% for UBL. Lowest ratio is 81% of FWB. In the year 2001, the ratio declined for the major banks, except for NBP.

Other Key Ratios

(%)

Banks	NBP 2000	NBP 2001	HBL 2000	HBL 2001	UBL 2000	UBL 2001	MCB 2000	MCB 2001	FWB 2000	FWB 2001
Equity/Assets	3.1	2.9	2.7	2.8	4.2	-0.5	2.6	2.7	2.3	2.6
Equity/Liabilities	3.2	3.0	2.8	3.0	4.4	-0.5	2.7	2.8	2.4	2.8
Liabilities/Assets	95.4	95.8	96.2	96.2	94.4	94.7	96.8	96.3	97.2	95.2
Provisions/Performing Advances	14.3	17.0	19.8	22.5	41.0	26.6	5.9	9.0	4.0	3.6
Equity+Provisions/NPLs	1.0	0.9	0.7	0.7	0.8	0.6	0.7	0.8	0.8	1.8
Net NPLs/Net Advances	8.6	10.7	13.8	14.4	17.4	19.5	9.1	9.3	18.8	11.3
Non Interest Income/ Total Income	11.9	15.1	19.2	16.5	22.4	20.2	16.4	11.4	10.1	4.1
Non Interest Income/ Revenue*	31.4	30.4	42.0	31.6	42.3	36.1	28.6	18.8	21.0	9.3
Operating Expenses to Income	22.3	25.3	38.2	37.1	35.2	36.9	42.6	38.3	40.2	24.0
Operating Expenses Revenue*	58.4	50.8	83.7	71.1	66.6	55.0	74.6	63.1	83.3	54.0

* *Net Interest Income + Non-Fund Based Income*

Source: Annual Reports of various banks

Conclusion

Improved operation of banks

Restructuring undertaken to improve the working efficiency of banks, and of NCBs in particular, resulted in separation of at least 30,000 staff and closure of a large number of loss making/non profitable branches. Restructuring and other strengthening measures initiated since past few years, is now reflected in improved performance of banks. The NCBs have re-instituted effective cost control and efficiency approach and are now working aggressively to manage low yield assets. There has been improvement in recovery of defaulted loans.

Banks being prepared for privatisation

The aim of reforms is to make NCBs competitive and prepare them for privatization. MCB and ABL were privatized in early 1990s. MCB has now become the largest bank in the private sector. At the same time, NBP's shares have been placed on domestic stock exchanges. Earlier in November 2001, 10% shares were offered to the general public. Another 5% shares of the bank were recently offered to the general public. The subscription was heavily over-subscribed. Habib Bank is likely to go private by the end of the year.

In 2001, all the major banks, by and large, remained profitable except for UBL. Its loss dragged down the profitability of other banks by 66%.

While all banks deposits grew, advances and investments have fallen. Despite the shrinking spread, revenue growth has been impressive. Interest income has also increased significantly.

Non fund based income falls

Non-fund based income has become more important to banks in recent years because of narrower net interest margins. However, all the major banks, with the exception of NBP, recorded fall in their non-fund income. NBP recorded significant growth reflecting improved performance of branch network. However, HBL still holds 34% of total non fund based income, the highest amongst major banks.

Administrative expense increases

Despite efforts to curtail operating costs, significant growth in administrative expense and staff cost was recorded by NBP, MCB and FWB. Both staff costs and administrative expenses continue to be high for HBL, though these have fallen over the year.

NBP maintains top position

NBP has maintained its position as Pakistan's largest bank in 2001. MCB has maintained profitable growth, alongwith proactive risk management and expansion of product range for customers. Prudent cost cutting measures at HBL have restricted growth in expenses. FWB has also shown an improvement in all financial activities. In UBL, the government injected capital of Rs.7.9 billion, enabling the bank to meet capital adequacy requirement shortfall created by Rs.7.2 billion, long overdue overseas loans not being available from the GoP and to meet other requirements.

While some financial ratios have improved, efforts are needed to bring them at par with internationally accepted standards.

Corporate Governance - Recent Initiatives

Enron & other corporate failures

In the aftermath of recent business failures in the US, involving companies such as Enron and World Com, one area that came into sharp focus was corporate governance practices and policies. A few years earlier also, when the East Asian crisis broke out, weaknesses in governance was cited as one of the factors responsible.

The Enron and other events showed the need for corporate law to keep pace with underlying changes in the financial world. The Netherlands Minister of Finance while addressing the joint IMF-World Bank meeting said, "there is a need to give as much attention to risks and vulnerabilities arising in the so-called advanced economies, as we do to problems in emerging markets and developing countries".

It also brought to light the rising demand for corporate accountability, and transparency and the need for Boards to be more knowledgeable, involved and proactive. The issue of how companies are governed has been given renewed relevance by recent incidents. This is true for countries that are considered to have close to perfect capital markets. In developing countries, the issue of corporate governance is even more important because of the weak legal system which cannot effectively enforce contracts and resolve disputes, poor quality of information which prevents effective monitoring and widespread corruption and mistrust.

Corporate governance defined

Corporate governance can be defined in a number of ways. The OECD in its paper, *"OECD Principles of Corporate Governance"* issued June 21, 1999, defines corporate governance as involving "a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined".

The collapse of Enron and other high profile companies, and the resultant impact on stock markets around the world are now forcing companies/stock markets/governments to focus on effective corporate governance.

Focus on effective governance

Certified Management Accountants (CMA) of Canada is developing a new corporate governance guideline that is designed to measure and improve the performance of board of directors and CEOs. CMA Canada is focusing on broader corporate governance issues, including: -

- defining the roles and responsibilities of boards,
- new auditor regulations,
- assessing business risk,
- evaluating the performance of senior managers,
- ensuring ethical and legal compliance throughout the top executive team.

The Australian government has tightened corporate governance and has come up with a tough reform package to clean up the country's corporate culture. The reform package would be introduced early next year.

China has taken a number of initiatives given the growing importance of good corporate governance, such as establishment of a system of independent directors for Chinese listed companies, the introduction of a code of corporate governance and the establishment of a National Accounting Institute opened just a year ago, where many professional CPAs and financial managers have benefited from its high quality training programmes.

Transparency and adequate disclosure cannot however, become established business practices without well trained and competent accounting professionals.

Nasdaq & NYSE adopt new proposals

In July 2002, the Board of Directors of Nasdaq Stock Market approved more than 25 new corporate governance reform proposals designed to increase accountability and transparency for the benefit of investors.

Action taken by the Nasdaq board include: -

- Increase board independence.
- Empower audit committees.
- Strengthen the role of independent directors in compensation and nomination decisions.

- Shareholder approval for all stock option plans.
- Code of conduct for companies.
- Mandate for accelerated disclosure of insider transactions.

The New York Stock Exchange (NYSE) has also approved in August 2002 stricter corporate governance standards and disclosure practices for NYSE listed companies. These are intended to restore investor confidence by empowering and ensuring the independence of directors and strengthening corporate governance practices.

Both the NYSE and Nasdaq after beefing up their corporate governance rules for their listed companies, have now made very specific reference to posting the information on corporate website. In the weeks immediately after the new rules were approved, a survey showed that a vast majority of 135 prominent companies have a long way to go to meet the new rules.

Only last month, the Malta Stock Exchange announced the setting up of a Mediterranean Corporate Governance Roundtable to promote and improve corporate governance in emerging markets. The main thrust will be with regard to the Mediterranean region, with its different cultures and background.

Large corporations adopt new systems

Corporate governance has become an integral part of many institutions. In May this year, Mazda announced a series of measures designed to improve the company's corporate management system and structure, including an Executive Officer system, a reduction in the size of the board and a plan to establish a management advisory committee. Through these, it hopes to enhance corporate governance and management efficiency.

Fujitsu is undertaking reforms of its corporate governance structure, including the streamlining of the Board and the introduction of Corporate Executive Officers and a new Business Group Organization. Colgate having incorporated principles of good corporate governance, has been given A-plus rating by CaIPERS, an institute which rates governance aspects of corporations.

Bank of Montreal has corporate governance as an integral part of its business focus. The Bank's governance programme rates the performance of each director against the standard of performance required by the board's charter of Expectations for Directors.

Effective corporate governance has assumed added significance for banks, because of the presence of the risk element. There are specific responsibilities to manage the risks at the financial institution and effectively oversee the system of internal controls.

Basel committee designs new strategies

The Basel Committee has in the recent past issued papers which underscore the need for banks to set strategies for their operations and establish accountability for executing these strategies. These papers have highlighted the fact that strategies and techniques that are basic to sound corporate governance include: -

- the corporate values and codes of conduct,
- a well articulated corporate strategy,
- the clear assignment of responsibilities and decision making authorities,
- strong internal control system,
- establishment of a mechanism for the interaction and cooperation among the board of directors, senior management and auditors,
- special monitoring of risk exposures,
- appropriate information flows internally and to the public.

While bank directors are not expected to understand every nuance of banking or to oversee each transaction, they however have the responsibility to set the tone regarding their institution's risk taking and to oversee the internal control process so that they can reasonably expect that their directions will be followed.

New standards to be introduced

The Basel Committee on Banking Supervision is ready with a set up of new standards as to how much capital banks must set aside to cover unforeseen hazards, and aim to be more sensitive to the risks in today's global banking industry. The new rules will reflect different types of risk and will rest on three pillars – capital requirements, supervisory review of internal bank risk assessments and market discipline through better risk disclosure.

Banks will have until December 20 to test the accord and give recommendations to the Basel Committee. It hopes to issue the final version of the accord in October next year and implement it as the standard in 2006.

Accounting is considered to be the soul of corporate governance. Only if strong principles of accounting are practiced can corporate management be monitored and held accountable and corporate performance be assessed. The basic accounting principles should be that every corporate accountant and every outside auditor should follow professional standards. Regulators, policy makers, investors and shareholders all rely on financial statement to assess a company's performance and financial standing.

Business Ethics in its March/April 2002 issue, lists four of the best proposals for reforming corporate governance.

§ Ensure auditors really audit by making them fully independent.

§ Bar law breaking companies from government contracts.

§ Create a broad duty of loyalty in law to the public goods.

§ Find truly knowledgeable directors: Employees.

Corporate governance initiative in Pakistan

In Pakistan, the Fifth All Pakistan Chartered Accountant's Conference held in December 1998 resolved to take an initiative to evolve and recommend a Code of Good Corporate Governance. The need to have a framework of good corporate governance was felt by all concerned with the corporate sector, including the investors, the financial services community, regulators and the accounting profession.

The objective of corporate governance framework is to establish a system, whereby a company is enabled to be directed and controlled by its directors having due regard to compliance with the best practices enunciated by the code for carrying out the conduct and affairs of a company.

The Securities and Exchange Commission of Pakistan, for the purpose of establishing a framework of good corporate governance has introduced certain principles which the stock exchanges have been asked to insert in their respective listing regulations. This have been highlighted below.

One can thus conclude that everywhere, whether it is a developing or developed country, the issue of how companies are governed has been given renewed relevance by the recent incidence involving financial irregularities at large companies. Need for disclosure has increased dramatically, and Boards are under more pressure than ever before, audit function in particular is under intense scrutiny.

Securities and Exchange Commission of Pakistan

Code of Corporate Governance Highlights

The Securities and Exchange Commission of Pakistan, for the purpose of establishing a framework of good corporate governance by listed companies issued a detailed list of clauses, which were to be inserted in their listing regulations. Given below are the highlights on the subject:-

Board of Directors

(i) All listed companies shall encourage effective representation of independent non-executive directors, including those representing minority interests.

(ii) The directors of listed companies shall, at the time of filing their consent to act as such, give a declaration that they are aware of their duties and powers under the relevant law(s).

Qualification and Eligibility to Act as a Director

(iii) No listed company shall have as director, a person who is serving as a director of ten other listed companies.

(iv) No person shall be elected or nominated as a director of a listed company if he is not a National Tax Payer; he has been convicted by a court of competent jurisdiction or is a defaulter of a financial institution, or if his spouse is engaged in the business of stock brokerage.

Tenure of Office of Directors

(v) The tenure of office of Directors shall be three years.

Responsibilities, Powers and Functions of Board of Directors

(vi) The directors shall carry out their duties with independence in the best interests of the listed companies.

(vii) Every listed company shall

(a) ensure that a statement of Ethics and Business Practices is prepared and circulated annually by its Board of Directors to establish a standard of conduct for directors and employees,

(b) the Board of Directors adopt a mission statement and overall corporate strategy for the listed company.

Meetings of the Board

(viii) The Chairman of the listed company shall preside over meetings of the Board of Directors, which will be held at least once in every quarter of the financial year and will also ensure that minutes of the meetings are appropriately recorded.

Key Information to be placed for decision by Board of Directors

(ix) To strengthen the corporate decision making process, significant issues will be placed for consideration and decision of the Board of Directors of listed companies.

Orientation Courses will be held for companies' directors.

Chief Financial Officer and Company Secretary

(x) The appointment, remuneration and terms and conditions of employment of the Chief Financial Officer, the Company Secretary and the head of internal audit of listed companies shall be determined by the CEO.

Corporate and Financial Reporting Framework
Director's Report to Shareholders

(xi) The directors of listed companies shall include statements to the following effect in the Directors Report.

§ The financial statements.

§ Proper books of account have been maintained.

§ Appropriate accounting policies have been consistently applied in the preparation of financial statements.

§ International Accounting Standards have been followed in preparation of financial statements.

§ The system of internal control is sound and has been effectively implemented and monitored.

§ There are no significant doubts about the listed company's ability to continue as a going concern.

§ There has been no material departure from the best practices of corporate governance.

Frequency of Financial Reporting

(xii) The SECP has clearly stated in detail the frequency of financial statements that needs to be published and circulated.

Responsibility for Financial Reporting & Corporate Compliance

(xiii) Circulation responsibilities of financial statement by CEO and the CFO spelt.

Disclosure of Interest by a Director holding Company's Shares

(xiv) If any director, CEO or executive of a listed company or their spouse undertakes any transaction in the shares of the company, they shall immediately inform the Company Secretary.

(xv) Auditors not to hold Shares.

Corporate Ownership Structure

(xvi) Every company proposed to be listed shall at the time of public offering offer not less than 20% of the share capital of the company, unless the limit has been relaxed.

Audit Committee

(xvii) The Board of Directors of listed companies shall establish an Audit Committee, comprising not less than three members, meeting at least once every quarter of the financial year.

Terms of Reference

Board of Directors shall determine the terms of reference of the Audit Committee. Among others, they will be responsible for the appointment of external auditors, determining appropriate measures to safeguard the listed company's assets, reviewing of financial statements, ensuring coordination between internal and external auditors, ascertaining the effectiveness of internal control system, etc.

All listed companies shall set out the status of their compliance with the best practices of corporate governance.

IMF - World Bank Annual Meeting

The International Monetary Fund and the World Bank held their 57th annual meeting in Washington on September 28-29. It was attended by financial leaders from 184 member countries who had gathered to present their countries views on issues in international economics and finance. The first annual meetings were held in Washington in 1946.

Wide range of issues covered

The two days meeting covered a wide range of issues from poverty reduction to corporate governance, corruption to trade distortionary subsidies, banking and corporate restructuring to debt burden restructuring, sovereign bankruptcy to investing in globalisation and the uncertainties surrounding the global economy outlook and the ways the Fund and the Bank can continue assisting members to strengthen their economies to make them stronger and more resilient.

Since the last annual meeting, the intervening period has been a difficult one. While the rich world witnessed the collapse of the stock markets and corporate scandals, the developing world saw wars and conflict, political disturbances, restrictions on trade, falling commodity prices, rising poverty, economic crisis in Latin America and a heavy toll on human life in Africa.

The world's seven richest industrial countries showed commitment to sound economic policies and structural reforms to improve corporate disclosure, enhance corporate accountability and strengthen the independence of auditing. They pledged to coordinate efforts to improve disclosure requirements for corporations.

Globalisation has assumed significance, for now no nation can afford to neglect the impact of its actions on the rest of the world. Integration in the global economy through trade, investment and the spread of technology has the potential to bring about stronger economic growth and better standards for all. However, there are challenges and risks that come with it.

There was broad agreement on the issue of poverty and coordinated efforts needed to fight against it. As the World Bank President remarked "today more and more people are saying poverty anywhere is poverty everywhere and their voices are getting louder". Economic growth is essential in reducing poverty for international experience indicates that when economic growth rate rises, poverty falls. Economic growth increases the demand for labour and also increases the availability of public and private resources that can be used to improve essential social services such as education and health care.

Coordinated efforts to fight poverty

The World Bank President said that an estimated average annual growth rate of the world economy of around 3.5% is needed to reduce poverty effectively and to meet the 2015 goals.

The Conference highlighted a "two-pillar" approach for overcoming world poverty, based on self responsibility and better international support. With the introduction of the Poverty Reduction and Growth Facility (PRGF), which replaced IMF's concessional lending facility ESAF, there has occurred a more prominent place for poverty reduction in the government budget.

PRGF brings good results

While the programme is only a few years old, an assessment of PRGF supported programmes show that actual public spending is becoming more pro-poor and pro-growth in countries with PRGF supported programmes. Most such programmes emphasize strengthening governance by improving public expenditure management. They are also characterised by greater fiscal flexibility, whereby the fiscal framework allows for an increase in poverty reducing spending when additional resources are available.

The developing countries need to pursue social and economic policies that encourage growth that is equitable and just for all, develop regulatory framework that is free from corruption, has a well regulated financial system which creates conditions for entrepreneurship and jobs.

Financial leaders from Africa, where many countries face extreme poverty spoke about the change that has taken place in their dealing with the problem. They have chosen a framework for cooperation with the rest of the world, a key element of which is poverty reduction in the continent. A home grown development process, programme will form the basis of cooperation with other institutions and donors.

Commitment to the Millennium Development Goals

The developed countries have reaffirmed to work in partnership with the developing countries - to increase overseas development assistance, to open markets in trade and to reduce agricultural subsidies. They reaffirmed their commitment to the Millennium Development Goals.

The Millennium Development Goals address issues of common interest to people of all nations. The goals comprise among others, eradicating poverty and hunger, achieving universal primary education, eliminating gender disparities in education, reducing under five and maternal mortality, ensuring environmental sustainability etc. The Annual Meeting called for setting 2015 as the year to achieve the goals. It will be a coordinated effort by the financial institutions and the countries to work in the fight against poverty.

On the issue of aid, delegates from the rich countries showed willingness to increase aid that is productively used. The World Bank President said, "untie aid and move to better coordinate and harmonize development programmes and policies. The fragmentation of donors' efforts has long plagued the effectiveness of aid. Many of the failures blamed on borrowing countries actually represent the failure of donors to coordinate their efforts".

Aid to be made effective

In developing countries, past experience has shown little coordination among donors. In countries, where there is coordination, aid has been effectively utilised. For instance in Ghana, a common donor approach brought improvements in the country's primary healthcare programme. In India, better coordination among donors on important education policy issues led to reforms in teacher training and financing. In Brazil, the World Bank has joined other donors in pooling health efforts and in Mali and Uganda, donors recently agreed to joint supervision of projects.

On the HIPC initiative, a major new issue that emerged at the Conference was how to deal with the fact that the outlook for many debt ridden countries has deteriorated with the global economic slowdown and the fall in commodity prices. Additional financing is clearly required.

The Heavily Indebted Poor Countries (HIPC) Initiative was launched in 1996 to reduce the external debt of the world's most debt-laden poor countries to sustainable levels by the combined efforts of Paris Club and other official bilateral and multilateral creditors.

Debt relief under the HIPC Initiative is one way of the international support for poor countries that removes debt as an obstacle to growth. Some 26 countries have recently been given debt relief of $40 billion, reducing these countries external debts by about two thirds from $62 billion to $22 billion. Resources are being allocated to education, rural development and water supply, and road construction.

The Chairman of the Annual Meetings and Finance Minister of Oman, called upon the industrial countries not to restrict access to the exports of developing countries, particularly textiles and agricultural products. They must open up their markets and the developing countries should also push ahead with their own liberalisation efforts.

The Pakistan Finance Minister while addressing the joint meeting also called upon the developed countries to provide access to markets. "What is the point of enhancing capital flows if capacity to repay them continues to be constrained by restrictive trade practices. We feel that trade must be placed even higher on the agenda of the development dialogue – we urge industrial countries to reduce tariffs and non-tariff barriers".

There is a process of change at the IMF. Further reforms have been initiated so that IMF's capacities match with the needs of the global economy. Views were also expressed that the current distribution of IMF quotas needs to be reconsidered, especially to correct the under-representation of a number of emerging market economies.

Banking and Finance

Deposits increase

Scheduled banks deposits rose by 19.6% to Rs.1,525.4 billion in the week ended October 12, 2002 against the corresponding week last year when it stood at Rs.1,275.6 billion.

Advances show a small rise

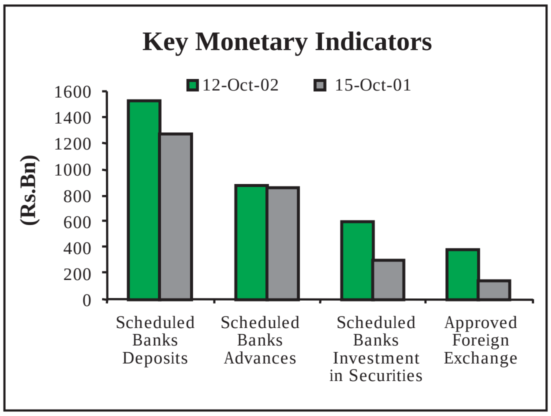
Scheduled banks advances stood at Rs.864.3 billion, a marginal increase of 1.5% over last year's corresponding figure of Rs.851.8 billion. Demand for credit by the private sector has been sluggish. It is expected to pick up in the near future for cotton financing.

Substaintial rise in investments

Scheduled banks investment in central and provincial government securities showed a substantial jump of 95.3%, rising to Rs.595.8 billion in the week ended October 12, against last year's corresponding figure of Rs.305.0 billion. As credit flow to the private sector has not picked up, banks with surplus liquidity have invested in these securities.

A near two-fold increase in approved foreign exchange

Approved foreign exchange including balances held outside Pakistan, showed a near two-fold increase, rising by183.3% to Rs.381.6 billion in the week ended October 12, 2002 against last year's corresponding figure of Rs.134.7 billion.



Privatisation picks up

Following the banking sector liberalisation process initiated in the early 1990s, banks have been set up in the private sector. The bigger nationalised banks, have for a number of years faced overstaffing, unprofitable branches, poor customer services and inept credit discipline. To minimize these weaknesses and to improve the overall operations of the banks, restructuring and then the subsequent privatisation of nationalised commercial banks has remained on government agenda, in spite of some initial difficulties.

Late last year, a 6.4% government stake in Muslim Commercial Bank was off-loaded and only 10.2% more shares remain to be divested. In October, 2002 the management ownership of United Bank Ltd, one of the largest banks from the public sector was transferred to the consortium of Abu Dhabi Group and Bestway Group who have acquired 51% shares.

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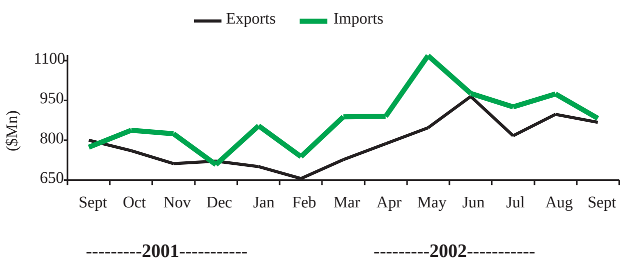
During the same month, the second offering of shares of National Bank of Pakistan by the Government of Pakistan through the State Bank of Pakistan of its shareholding in the Bank, equivalent to 5% of the Bank's total issued, subscribed and paid up capital took place. In addition to this, in case of over subscription, the Offerer shall offer out of its shareholding in the Bank a maximum of 5% of the Bank's total issued, subscribed and paid up capital. It was heavily oversubscribed. Last year, the government offloaded 10% shares of NBP through initial public offering in the local stock exchanges.

Habib Bank Ltd is in the process of privatisation, and the Privatisation Commission has invited Expressions of Interest from the investors for a minimum of 26% stake of the Bank.

Trade

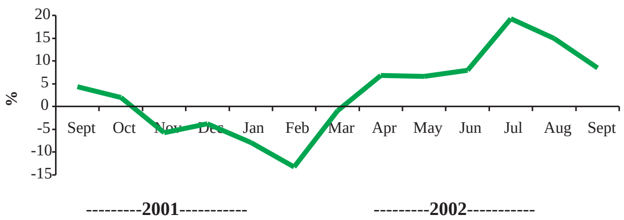
Pakistan's merchandise trade account shows a significant improvement in the first quarter of FY03, with export/import gap narrowing to a provisionally estimated $201 million, down 16% from a year earlier. This improvement is attributable to an accelerated growth in exports of 14%, which outpaced an 11% increase in imports. Last year, in the corresponding period, the trade deficit had declined by 53%, mainly on account of an 8% decline in imports in contrast to only 2% growth in exports.

Trend in Exports & Imports



Exports this year are showing a steady growth since March and have come very close to the target set by the Ministry of Commerce for the quarter. The Ministry has fixed an export target of $10.4 billion for the whole fiscal year, growing 15% on annual basis. In the first three months (July-September), exports fetched an estimated $2.58 billion, or 25% of export target.

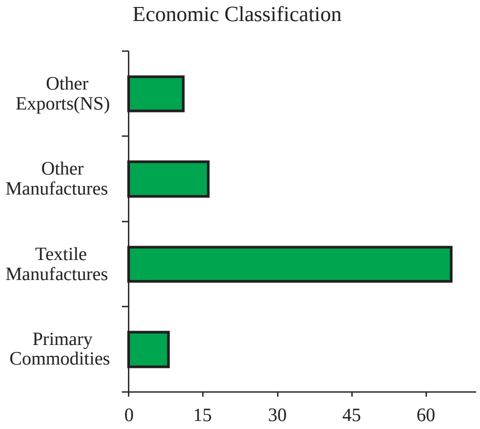
Growth in Exports

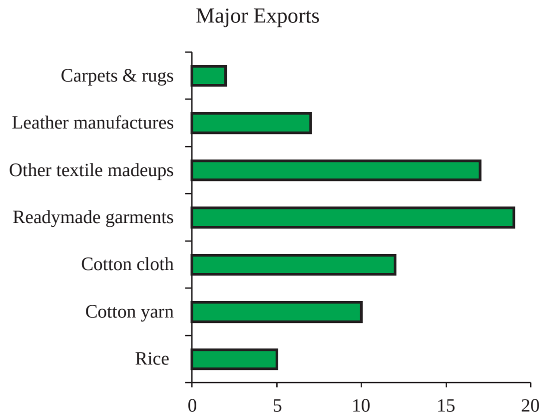


Although there have been some inroads in capturing new markets for non-traditional items, the country continues to depend on the export of traditional items. Despite efforts to expand the export base, nearly 65% of export earnings continue to be derived from cotton based textiles manufactures alone. During July-September FY03, textile manufactures exports increased 15% to $1.67 billion.

Export Structure

% share in total exports





Primary commodities, with a share of 8% in total exports, recorded nearly 12% growth. Other manufactures exports declined by 12% and their share in total exports came down to 16% from 21% a year earlier.

Among major exports, raw cotton, cotton yarn, cotton cloth, readymade garments including knitwear and bedwear & towels recorded increase in export value. However export of rice, fish & fish preparations, carpets & rugs, leather tanned & manufactured, sports goods and surgical instruments suffered decline.

The average unit value of most major export items with higher export value (raw cotton, cotton yarn, readymade garments) declined but that of rice, cotton cloth, carpets & rugs and leather with lower export value, was higher compared to a year earlier.

Major Exports

($ Mn)

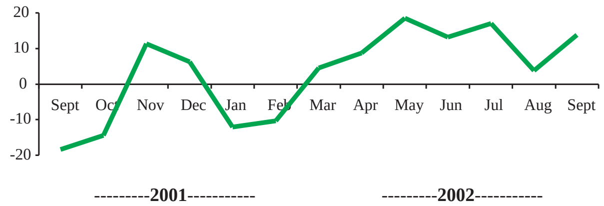
	FY00	FY01	FY02	July-September FY03	July-September FY02
Rice	539.7	525.5	448.2	95.5	103.7
Raw Cotton	72.6	139.3	24.7	15.0	3.2
Fish & Fish Preparations	138.9	137.8	123.6	33.1	35.4
Fruits & Vegetables	118.5	101.0	102.1	23.0	22.5
Wheat	-	11.0	71.4	33.1	12.0
Cotton Yarn	1071.6	1073.5	929.7	243.1	239.6
Cotton Cloth	1096.2	1032.5	1130.8	318.7	246.0
Readymade Garments & Knitwear	1658.4	1738.2	1720.9	539.0	476.4
Other Textile Made-up*	1213.1	1317.5	1537.0	451.6	375.2
Synthetic Textile Fabrics	457.6	544.6	410.0	116.3	114.7
Carpets & Rugs	264.3	288.8	249.8	44.8	47.8
Leather Tanned & Manufactures	513.8	658.4	623.1	147.3	184.3
Sports Goods	279.2	270.6	304.5	58.8	61.1
Chemicals & Medicines	220.1	288.4	297.8	85.2	64.4
Petroleum Products	81.9	183.9	190.7	38.2	66.0
Others	842.7	890.5	698.1	383.6	212.2
Total	8568.6	9201.6	9134.5	2581.2	2264.5

* including bedwear & towels

Source: Federal Bureau of Statistics

Imports into Pakistan have shown a rise since March this year. First quarter imports surged 11%, in sharp contrast to an 8% fall in the corresponding quarter last year. Cheaper imports due to weak dollar, alongwith revival of industrial activities contributed to this increase. Imports during July-September FY03 are in line with the target for the quarter. The Ministry has announced an annual target of $11.1 billion for the whole fiscal year.

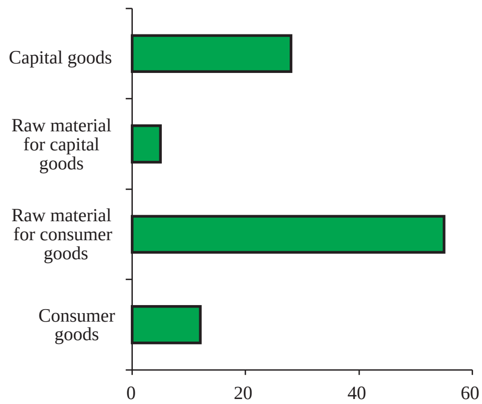
Growth in Imports

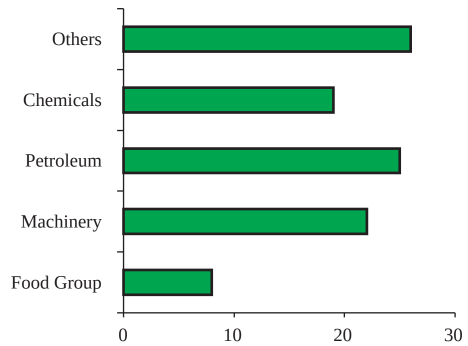


A wide range of commodities are imported into Pakistan. Though there has been a shift in import composition, raw material for consumer goods still account for more than 50% of total imports. Groupwise, share of food group imports have gradually declined, as they now account for only 8% of total imports. During July-September FY03, despite a 34% fall in wheat imports, food imports showed a 30% growth. The increase is attributable to a significant rise in edible oil imports (71%). Economic classification of imports reveals heavy reliance on import of raw materials for consumer goods and import of capital goods. The share of consumer goods is gradually declining.

Import Structure

% share in total exports





Major Imports

($ Mn)

				July-September	
	FY00	FY01	FY02	FY03	FY02
Wheat	283.5	15.4	50.0	7.0	10.7
Tea	210.4	206.4	156.6	37.8	36.6
Edible Oil	413.4	327.6	393.0	122.7	71.7
Pulses & Spices	112.9	131.6	152.9	47.8	30.6
Fertilizers	197.6	170.5	176.2	61.6	50.8
Petroleum (Crude & Product)	2804.4	3360.8	2807.0	618.4	493.1
Insecticides & Medicinal Products	350.1	299.9	314.0	81.1	83.4
Plastic Materials	332.9	354.3	352.7	98.3	78.2
Synthetic Textile Fibre	152.6	161.8	187.5	54.7	40.2
Iron & Steel	372.3	361.4	433.9	102.6	116.9
Transport Equipment	524.6	400.5	462.2	121.7	85.4
Electric Machinery	155.0	131.6	128.0	44.6	24.6
Non Electrical Machinery	437.9	537.3	562.8	131.4	132.9
Textile Machinery	211.0	372.2	406.9	107.2	118.6
Others	3750.8	3897.6	3755.8	1145.5	11304
Total	10309.4	10728.9	10339.5	2782.4	2504.1

Source: Federal Bureau of Statistics

While the oil import bill declined by 7.5% in the quarter, it still constitutes 25% of total imports. Machinery imports, with a share of 22% in total imports, rose by 25% compared to 7% growth the previous year. Chemical imports grew by 8%, fertilizer by 21%, plastic materials by 25%. Iron & steel imports on the other hand dropped by 14%.

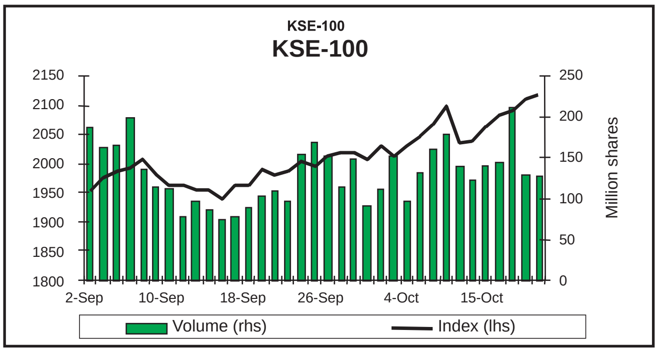
The average unit value of imports of some major items, mostly consumer goods, was higher during July-September FY03. These include tea, edible oil, fertilizers and sugar. On the other hand, average unit price of wheat, pulses, insecticides and medicinal products, plastic materials and synthetic textile fabrics recorded decline. In value terms, import of pulses, plastic materials and synthetic textiles were higher, while that of wheat, insecticides and medicinal products declined.

Market Analysis

Eight Year Highs

The current Bull Run is showing no signs of taking a breather. The market continued its up trend in the month of September and October. Earnings announcements from Hubco and PTCL were in line with market expectations and so were not the main driver of the market. The market was primarily driven by rumors of PSO's privatization, and then later by the positive developments on Indo-Pak border situation.

Despite making a two-day fall immediately after the October elections, the market made a strong comeback to clearly breach the 2100 level by the end of the following week, an eight-year high. This reflects the underlying strength of the bull market, which began its growth one year ago and shows no sign of stopping. Some of the reasons for this tremendous performance are reviewed below.



Strong Fundamentals

The current rally is fundamentally different from the rally of March-April 2000 when the index was last above 2000. That rally was founded more on speculative grounds than fundamentals- with a few big players pushing prices up by acquiring selected stocks and leveraging themselves against those shares. The economy was in bad shape back then with international sanctions still in force, profits of corporations down YoY (PTCL and PSO), Hubco and Wapda still at loggerheads, high interest rates, a fast devaluing rupee, and capital flight.

This time, a positive chain of events triggered post 9/11/01 have altered the market scenario completely: sanctions have been lifted, interest rates are low, forex reserves are at an all time high, the rupee is gaining strength, there is negative capital flight (inflows), corporate earnings have improved (Hubco, PSO, Shell, Unilever, PTCL to name a few blue-chips), and the privatization program is finally gathering momentum - UBL, PSFL, oil and gas fields sold, with PSO, HBL, NIT and ICP on the anvil.

The net capital inflow, combined with low interest rates, has meant there is a great deal of extra liquidity in the financial system that needs to be invested in financial assets. With low interests rates, restrictions on investment in NSS, low after tax yields on debt instruments, and a stock market that has been the best performing market in the world this year, traders are increasing their exposure in the market and new investors are also taking a closer look at equities. The focus is gradually shifting to stable, dividend yield stocks.

Low Badla rates and value

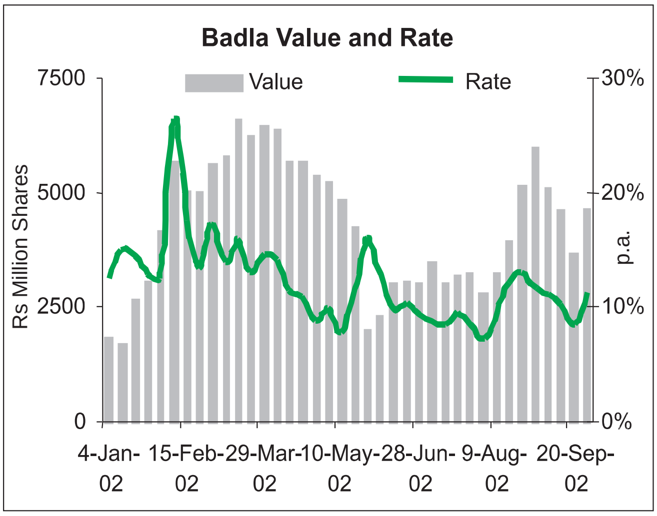
Badla is the lifeline of rally initiators and weakholders; we have been witnessing stable low badla rates throughout the last one-year, except when Indo-Pak tensions escalated close to war in May (see graph). Lately, bear market advocates have been pointing to the outstanding badla volume of around Rs5b as a cause for concern, on the grounds that any bad news in the market would result in panic selling of leveraged positions.

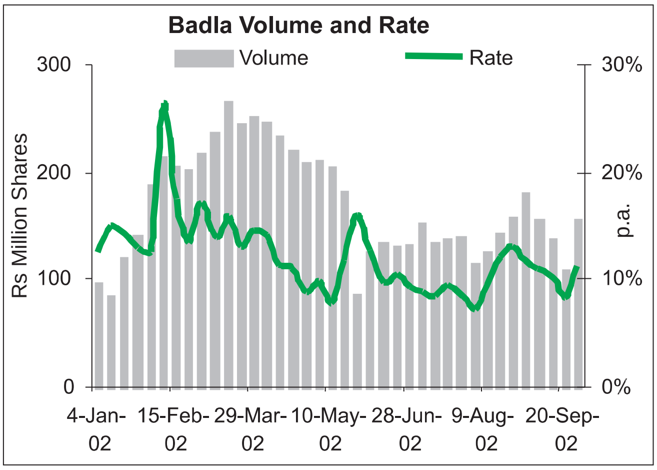
However, if we look at the badla market for the year 2002 we find:

- The average badla value has been in the range of Rs4b to Rs5b, the current badla value is also in that range.
- Badla volumes (number of shares) of pivotal stocks other than PSO - PTCL and Hubco - have been declining since March.
- Weak holders have continued with their exposure in PSO in the hope that the company will be privatized. Even with the high weak holding, the badla volume and rates are stable.

The reasons are that long-term dividend yield investors have accumulated at lower levels. The market is flushed with liquidity and the low badla rates demonstrate that financiers perceive low risk in the market. The low rates in turn mean low cost of holding, and with other alternatives less attractive (other money market instruments) we do not foresee any significant increase in the badla rates in the near future.

Hence, the *badla* market has been stable in the first nine months of the year, with one big variation due to Indo-Pak tensions. Since external factors are not in anybody's control they will continue to affect the market. Other than that, we believe the *badla* market will remain stable in the near term, as compared to other alternatives it still gives a reasonable spread for the risk taken by the financiers.





Recommendation

Thus, in the short to medium term, we believe the conditions are ripe for a sustained net inflow of funds into the equity market which, in turn, will push up equity prices and lead to higher price to earnings multiples.

Furthermore, we believe many stocks have not achieved their fair values so there is further upside potential. We expect good quarterly earnings for the July to September period. All of this, combined with the positive sentiment and low *badla* (carryover financing) rates advocates for a further upside and we foresee the market appreciating further in the near term. We think the bull market that began a year ago shows no indications of breaking down.

The only dark cloud on the horizon is a possible US attack on Iraq. The elections, the political environment and the formation of the new government will also be a major factor in deciding the direction of the market. An attack on Iraq, with all its attendant risks, would be negative (at least in the short-term) not only for the Pakistan equity market, but for regional and global markets as a whole. Both factors could generate some near-term market choppiness, which, in our opinion, would be an opportunity to trade portfolios by reducing positions at current levels, with a view to reinvesting on dips. First time investors should adopt a gradual *accumulate on dips* strategy.

Key Economic Indicators

Economy Size & Growth		1998-99	1999-00	2000-01	2001-02P
GNP - Market Prices	Rs bn	2912.8	3102.3	3365.4	3752.5
GDP - Market Prices	Rs bn	2938.4	3147.2	3416.3	3726.6
Per Capita Income	Market Prices Rs	21899	22811	24198	26413
	Market Prices US $	438	441	414	427
Growth					
GDP	%	4.18	3.91	2.45	3.61
Agriculture	%	1.95	6.09	-2.64	1.39
Manufacturing	%	3.73	1.53	7.58	4.39
Services	%	4.99	4.79	4.79	5.09
Rate of Inflation	%				
Consumer Price Index		5.7	3.6	4.4	3.5
GDP Deflator		5.5	2.8	5.6	4.6
Balance of Payments	$ mn				
Exports (f.o.b.)		7528	8190	8933	9133
Imports (f.o.b.)		9613	9602	10202	9493
Trade Balance		-2085	-1412	-1269	-360
Services Account (Net)		-2618	-2794	-3142	-2620
Private Transfers (Net)		2274	3063	3898	4255
Current Account Balance		-2429	-1143	-513	1275
Fiscal Balance	% of GDP				
Total Revenue (Net)		15.9	17.1	16.0	17.1
Total Expenditure		22.0	23.6	21.3	23.7
Overall Deficit		6.1	6.6	5.3	6.6
Domestic & Foreign Debt					
Domestic Debt	Rs bn	1375.9	1559.9	1712.5	1695.5
As % GDP		46.8	49.6	50.1	46.0
Total External Debt[b]	$ bn	31.3	32.3	32.1	33.4
Total Debt Servicing	Rs bn	343.1	353.9	340.3	412.5
As % GDP		104.2	105.4	113.2	102.0
Investment & Savings	% of GNP				
Gross Investment		15.6	16.2	16.2	13.8
Fixed Investment		14.0	14.6	14.5	12.2
National Savings		11.8	14.3	15.3	13.8
Domestic Savings	% of GDP	12.9	15.8	16.9	13.8
Foreign Investment	$ mn	403.3	543.4	182.0	474.6
Portfolio		27.3	73.5	-140.4	-10.0
Direct		376.0	469.9	322.4	484.7
Monetary Aggregates	%				
M1		33.9	14.9	3.0	14.9
M2		6.2	9.4	8.9	14.8
Interest Rates (Weighted Average)	%				
Deposits*		7.96	6.62	6.58	4.60
Advances		14.8	13.52	13.61	13.19
Gold & Foreign Exchange Reserves	$ mn	2922	2766	3810	6997
Exchange Rate++	Rs./$				
Official Rate		51.6	52.16	64.4	60.05
Open Market Rate		54.4	54.82	66.7	60.20

P Provisional
* PLS & Interest bearing
++ End-June Buying Rate

Source: Annual Report 2001-02
State Bank of Pakistan

NBP Performance at a Glance

(Rs. Bn)

Items	1997	1998	1999	2000	2001
Income	34.2	34.5	35.3	33.7	35.8
Expenditure	33.2	32.4	34.8	32.7	32.8
Pre-Tax Profit/(Loss)	0.996	2.14	0.52	1.03	3.02
After-Tax Profit	0.06	0.53	0.03	0.46	1.15
Total Assets	310.6	325.1	350.4	371.6	415.1
Deposits	254.9	273.4	294.8	316.5	349.6
Advances	105.6	109.5	122.6	140.3	170.3
Investments	109.5	102.9	91.5	72.6	71.8
Number of Branches	1468	1434	1431	1228	1245
Number of Employees	18096	15785	15541	15351	15163