ECONOMIC BULLETIN

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Contents

Editor's Corner

Dear Readers,

Recent years have seen Islamic banks spreading out not only in the muslim countries but in Europe and the US. This has been accompanied by product development, Shariah harmonisation, the emergence of a distinct Islamic capital market, where investment and financing activities are structured in accordance with Shariah principles. Shariah prohibits the trading of short-term debt instruments at other than face value. Islamic financial institutions have limited investment opportunities available for their current assets. Sukuk, an innovative Shariah compliant capital market product, provides an opportunity for those who want to invest according to Islamic principles.

It is one of the most significant mechanisms for raising finance in the international capital markets in ways which are Shariah compliant. Its market has expanded from regional Islamic investors to international institutional investors and is a sign of the growth of the global Islamic financial service industry in recent years. Multinational corporations, sovereign bodies, state corporations and financial institutions are beginning to use international Sukuk issuance as an alternative to syndicated financing.

To be Shariah compliant, Sukuks must be asset linked, they are for example, often backed by pools of ijara (leasing) contracts. Furthermore, backing by real assets ensures that a Sukuk is tradable in a Shariah compliant secondary market. This is because if a Sukuk were linked to pure receivables (arising for example under a murabaha sale) it may encounter the Shariah prohibitions on debt trading.

The Sukuk market has been a primary area of growth in both short- and medium-term placement of funds. This development has been fuelled not only by the desire of institutions to raise funds in a Shariah compliant manner, but also by investor demand for such products. For example, last year in order to attract Middle Eastern investors, the German Federal State of Saxony — Anhalt with no Islamic constitutional links, issued Shariah complaint Sukuk certificates; further evidence of the rapid move of Islamic finance towards the mainstream.

The attractiveness of Sukuk bonds can be gauged from some recent transactions. The US$700 million Qatari sovereign issue attracted 72% investors from Middle East and 28% from outside the region. The Bahrain Monetary Agency Sukuk attracted 22% investors from Europe, 12% from Asia and 66% from the Middle East. Of the Euro 100 million issue for the German State of Saxony —Anhalt, over 70% of the issue was sold in Europe to non-Islamic investors.

In January 2005, Pakistan made its debut in the international market. The first sovereign Islamic Sukuk issue offered a return of 220 basis points above the 6-month LIBOR, and had a five-year maturity period. Against the total subscription of $ 1.2 billion, which these Sukuk bonds attracted, the government accepted $ 600 million. The Eurobond floated earlier in February 2004, was priced at 375 points above LIBOR.

Once again the attraction by region and by type of investor can be seen in the profile of investors. The regional distribution was: investors from Saudi Arabia, the Gulf and the Middle East purchased 47% of the bonds; Asia investors picked up 31%; and the investors from Europe were able to buy 22% of the amount needed. The organisational profile of investors shows that State and government backed entities and businesses turned out to be the biggest investors with 24.5% purchases. Asset managers picked up 23.4%, Islamic banks 20.3%, other banks for trusts 18.3%, private banks 10.7%, corporates 2.0% and insurance companies 0.8%.

There is massive growth potential, as consumers and investors hunt for attractive alternatives to the conventional products typically on offer. Although still in its infancy, the market is developing at significant pace and most likely 2005 will show an annual volume of the Sukuk market exceeding for the first time US$10 billion benchmark and would expand further in the years to come.

Presently only a small proportion of Sukuks are traded, with most investors taking a buy to hold approach. As more Sukuks are issued, investors are likely to begin trading Sukuks to generate greater returns on capital invested and to create liquidity.

Ayesha Mahmud

Abstract of the Bulletin

Islamic Banking: The Emergence of Riba Free Solution

- Recent years have witnessed an increasing focus on Islamic finance worldwide.
- Islamic finance provides a range of Shariah-compliant products.
- Today there are more than 150 Islamic banking institutions not only in the muslim countries but they also operate in non-muslim countries.
- Islamic banks are actively involved in financing the growing needs of their customers.
- Islamic banks will need to focus on product development.

Development of Islamic Banking Products

- International financial institutions offer a wide range of products as well as wider range of asset classes; money markets and equities.
- Products have been developed in accordance with the basic principles of Shariah. The products include among others, Mudaraba, Musharaka, Murabaha, Salam, Istisna and Ijarah.
- Product development takes place in a number of stages; need assessment of customers, draft preparation and presentation to Shariah Board, their subsequent evaluation, review by the banking and legal experts and their submission of amended report to the Shariah Board and then their final approval.

Islamic Banking: Achievements, Opportunities and Challenges

- There is a growing integration of Islamic finance into the mainstream finance industry and global economy. The Islamic institutions now offer a wide range of products designed to serve the growing market.
- Islamic financial institutions more diverse and innovative are emerging on the scene. Most notable among them are AAOIFI, IFSB, LMC, and Lubuan Offshore Capital Market.
- An important innovation in Islamic finance is the emergence of Sukuk – an innovative Shariah compliant way of raising additional funding.
- Islamic finance is expected to grow, given the huge market.

Role of the State Bank in Islamic Banking

- The State Bank of Pakistan is playing a proactive role to support Islamic banks to develop in the country.
- There is a full-fledged Islamic banking department at the State Bank. A Board has been set up comprising of scholars and experts to advise the Bank on modes, procedures, laws and regulations for Islamic banking.
- A three-pronged strategy has been adopted by the Central Bank to facilitate the development of Islamic banking institutions, so they could operate in parallel with the conventional banks.
- State Bank has developed certification courses to develop the human resource base needed in this new area, also ensures audit once a year and on-site inspection to check for compliance.

Agriculture

- Agricultural growth has shown a fluctuating trend in the last five years from a decline of 2.2% in FY01, to an increase of 2.6% last year.
- While growth in agriculture has lowered food poverty in rural areas, it has not led to increase in income.
- Rising population exerts pressure on the agricultural sector and it requires a series of measures to improve crop productivity.
- Rice crop in the current year is expected to be higher than last year, while sugarcane production is expected to be lower. Meanwhile, cotton output would surpass the year's target and previous year's output.

Market Analysis

- January and February 2005 mark perhaps the most bullish period in the history of the KSE. Over these two months, the KSE-100 Index gained 2043 points or 33% to close February at 8261 on buying in heavyweights in the oil, gas telecommunications and banking sectors. The upcoming privatization of major companies is the primary driver behind the market at present.

Islamic Banking:
The Emergence of Riba-Free Solution

*Zafar Ali Khan**

"Those who devour Riba shall rise up before Allah like men whom Shaitan has demented by his touch; for they claim that trading is like usury. But Allah has permitted trading and forbidden usury. He that receives an admonition from his Rabb and mends his ways may keep what he has already earned; his faith is in the hand of Allah. But he that pays no heed shall be among the people of fire and shall remain in it forever."
(Surah Al Baqarah 275)

Expand-ing scope of Islamic finance

With the expanding focus and scope of Islamic finance worldwide, there is a rapid proliferation of feasible solutions that cater to almost all financial requirements. From equity based investment financing and complex corporate structured finance, to the broad based product and service scope of consumer (retail) banking, Shariah compliant financing is proving sound in both theory and practice.

Islam is a complete religion; it provides guidance for each and every aspect of human life. Economics is one of the most important aspects, as every human being needs involvement in some kind of economic activity for survival. Islam has provided a complete economic model for a establishing a healthy society. A very important pillar of this model is the prohibition of Interest or Riba, which is made clear by the following Qur'anic verse in which Allah (SWT) says:

"O, believers, fear Allah, and give up what is still due to you from interest (Riba), if you are true believers. If you do not do so, then take notice of war from Allah and His Messenger. But, if you repent, you can have your principal. Neither should you commit injustice nor should you be subjected to it."
(Al Baqra 278-279)

Over the past few decades the Muslims across the globe are seeking means to ensure that their financial and economic dealings are in accordance with the principles of Shariah. Today, we are witnessing the rapid growth in Islamic Banking worldwide. Islamic Banks are now operating in over 75 countries across the world.

Shariah is the guiding principle

The guiding principles for an Islamic bank and the Islamic financial system in general is a set of rules and laws, collectively referred to as Shariah. This governs the economic, social, political and cultural aspects of Islamic societies. Shariah originates from the teachings of the Quran and its explanations rendered by Prophet Muhammad (SAW), more commonly known as Sunnah.

The Shariah prohibits interest or usury, gambling and gharar (undue risk taking), involvement in trading in such goods and services that are unlawful in themselves. It also encourages risk- and profit-sharing in the sphere of financial activities as 'the essential principle of interest-free banking is profit/loss sharing'.

Islamic banking products

As such, Islamic banking products are fundamentally and conceptually different from conventional banking products, although in order to facilitate customer ease and clarity of understanding, such products often emulate the packaging and presentation of conventional banking products. This does not mean that these products are the same as those offered by conventional banks. Islamic Banks serve the same purpose to customers and the functions of Islamic banks are and will remain essentially that of financial intermediaries. However, all banking transactions and services remain in strict conformity with the Shariah principles.

While Islamic banking may not be a totally new concept, the widespread expansion of this form of banking is certainly a fairly recent phenomena. There are more than 150 Islamic banking institutions and these institutions not

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only operate in Muslim countries, but have also gained footing in non-Muslim countries.

Islamic banking in Pakistan

In Pakistan, the Islamic Banking movement has had a checkered history, with an initial noble intention but an ineffective execution, resulting in the dilution of the credibility of this model and the misunderstanding of its essence in the minds of the public. In 1999 ruling by the Shariah Appellate Bench of the Supreme Court, directed all the existing interest banking laws to cease. This paved the way for the State Bank of Pakistan, the government and prominent banking experts to make required initiatives to commence Islamic Banking in the country.

First Islamic bank is setup

In 2001, the State Bank of Pakistan outlined the criteria for establishment of Islamic commercial banks in private sector and subsidiaries and stand-alone branches by existing commercial banks to conduct Islamic banking in Pakistan. Finally, in the year 2002 the State Bank of Pakistan issued the first Islamic banking license to Meezan Bank Limited as the dedicated Islamic Bank in Pakistan. Since then the Islamic Banking industry is rapidly growing with the entrance of new-dedicated Islamic Banks and existing banks opening Islamic Banking branches.

Banking facilities provided by Islamic banks

The central objective of Islamic banks is to provide banking facilities and services in accordance with Islamic principles, rules and practices. This means Islamic banks provide saving facilities to depositors and extends financing to meet fund deficits. Normal deposit facilities such as savings accounts, current (checking) accounts, fixed or investment deposits are available to customers. Islamic banks are also involved in facilitating international trade for their customers (Islamic Export Refinance Schemes). Services such as letters of credit, bills for collection, letters of guarantee, buying and selling of foreign currencies, and remittance services are also available.

Islamic banks are also actively involved in financing the needs of their customers. This means providing short, medium- and long-term funding facilities. Since the Islamic banks are prohibited from making loans with interest to their customers, all financing operations are either based on profit-loss sharing or based on fixed charges. The principles of Mudaraba and Musharaka based on profit-loss sharing concepts are used by Islamic banks in financing working capital needs and long term financing. Principles of Murabaha are used by banks to finance the purchase of raw materials and occasionally fixed assets by customers. For buying machinery and heavy equipment, the principles of Ijarah and diminishing Musharaka are employed.

Advisory services provided

Advisory services are also provided at Islamic banks in many countries. These services include project planning, property management, preparation of feasibility studies, project evaluation, trustee services and training and education in Islamic finance and economics. Unlike conventional banks, some Islamic banks are also actively involved in social activities. The services that are considered as social services include, benevolent loans, collection and distribution of Zakat funds, donation and activities that will enhance Islamic values and ways of life.

Takaful

In addition, the Insurance Ordinance of 2000 had for the first time in the history of Pakistan made provision for the business of Takaful or Islamic cooperative insurance, based on the concept of mutual assistance. However, under the Insurance Ordinance, the Takaful business may only be conducted in accordance with rules prescribed in this regard by the Securities & Exchange Commission (SECP). Despite vigorous lobbying by insurance companies as well as concerned institutions, the SECP has not as yet notified the rules for Takaful business. Islamic banks are in dire need of the availability of the Takaful alternative, as it would thus enable them to address this area as well.

All financial institutions in general and banks in particular have undergone profound changes in their business functions. As they are facing increasing challenges from other capital markets, financial intermediaries are still growing through the avenue of continuous financial innovation. As a result, in the global financial market, although the role of financial intermediation as an institution is declining, its functional importance is on the rise in several modern economies.

Product development need to be focused upon

Product development is an important area in which Islamic banks will need to focus its resources. The industry started mainly with basic Murabaha transactions and since then has acquired some experience, investor as well as customer confidence and trained human resources. The way that lies ahead is to lead the industry towards a concentrated approach to developing new and unique products and improve the existing ones in terms of reduced costs and efficiency in delivery. This will, in turn, ensure penetration and consolidation in new and existing markets respectively, and enhanced profitability.

Islamic banks leading the way

Islamic Banks are truly leading the way forward in establishing a real, stable, and dynamic Islamic Banking system. This has become possible due to the guidance of its highly qualified and globally renowned scholars, who as a whole bring together a rich knowledge base of Islamic Fiqh accumulated over the past 1400 years. Furthermore, with the able support of the State Bank of Pakistan's Islamic Banking Department, all the products offered by the bank are very thoroughly scrutinized by these Shariah specialists in Islamic finance, hence approval of these products is not based on unqualified individual opinion or views, but on very sound assessment and jurisprudence.

Development of Islamic Banking Products

*Hasan Effendi**

The journey of Islamic Banking commenced in the late 1950s. Since then it has come a long way, when it used to be considered peculiar. Keeping in view the current scenario one can assess that Islamic Banking has gained impetus and is now growing at a rapid pace.

Islamic financial institu-tions growing

The growth of Islamic Financial Institutions (IFIs) across the globe, particularly in the Arab world, and in the West can be gauged by the rapid development of IFIs in the past 15 years with sizeable amount of investments running in billions of US dollars. This was due to the confidence and trust of investors in Shariah compliant products.

Despite the pessimism by the conventional industry, Islamic Banking has mushroomed over the last three decades, so that today there are over 300 IFIs in nearly 50-75 countries with hundreds of branches and thousands of employees offering products and services to millions of Muslims worldwide.

The success of this sector signals that the businesses in the modern economy can be managed and run successfully without the element of RIBA in compliance with the principles of Islamic Law and Shariah.

At the core of Islamic finance are the religious percepts governing what is good and permitted or lawful and what is harmful and forbidden or unlawful.

In the beginning, IFIs offered customers current accounts and commodity Murabaha investments. As the need grew, IFIs offered wide array of products as well as wider range of asset classes from money markets and equities. Countries like Bahrian and Malaysia led the trail by issuing Islamic Bonds in the form of Sukuk.

IFIs can be classified into various categories according to the services they are providing.

They can be divided into the following broad categories: -

Islamic Banks
Islamic Windows
Islamic Investment Banks & Funds
Islamic Mortgage Companies
Mudaraba companies
International Islamic Financial markets
Takaful companies (Islamic Insurance companies)

Conventional Financial Institutions assessed the growing need and offered similar products and services as their Islamic counterparts by managing both the conventional and Islamic products.

They have a competitive advantage over IFIs in the sense that they have continued to operate since long, have well-developed infrastructure, the necessary skills and expertise and have a large clientele base to whom they can offer Shariah compliant products.

IFIs started in the 1950s

As discussed earlier that the evolution of IFIs started in the late 1950s as compared to the conventional financial institutions and Insurance houses which evolved in the 17th century notably in Britain. In that era, major advancements and significant developments occurred in mathematical techniques pertaining to finance and risk management.

The industrial revolution of late 18th & 19th century further strengthened the concepts of conventional banking and finance.

Unfortunately at that time in the Muslim world no such developments occurred. Western styled financial institutions started penetrating in the Muslim countries.

The oil rich Muslim countries with excess liquidity in the form of Petro dollars started investing excess funds, but the only choice they had was to invest in Interest bearing products.

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This situation constituted a major thrust to the development of Islamic Banking Institutions and products.

Product development

Product development in Islamic Finance started with the work of classical jurists who developed products in accordance with the basic principles of Shariah. These products were developed by remaining within the boundaries of a specific branch of Islamic jurisprudence known as Fiqh al-mu'amalat (laws of transactions).

The products developed by the classical jurists are many in number but Mudaraba, Musharaka, Murabha, Salam, Istisna and Ijarah have become more usable and popular.

Initially fewer products so developed served as a benchmark for the contemporary Shariah scholars in developing new products catering to the needs of changing business environments.

The process of product development in Islamic finance is confined to imitating the products and services offered by the conventional financial industry. This has happened due to the lack of participation of Muslims in the development of world financial systems.

But one should keep in mind that the imitating needs lots of research and innovation in order to produce a product which functions within the principles and guidelines of Shariah, and is yet in conformity to market's acceptability and expectations.

Product development should take shariah into consideration

Before developing any product the underlying principles of Shariah are taken into account. These principles pertain to the basic guidelines outlined in the Islamic Jurisprudence. A legitimate Islamic product should be free from Riba (interest), Gharar (uncertainity), Maysir (gambling) and Jahalah (uncertainty in contract). Besides a product should comply with all the features of Islamic Contract Law, which clearly defines the capacity of parties involved or benefiting from the product.

The first step in product development starts with the need assessment of customers. After the need has been identified, a draft of the product is prepared and presented to Shariah Board to seek solution in order to make a product Halal and legitimate. The Shariah Board evaluates the product from all perspectives and gives outlines, which serve as a benchmark for further review by Banking and Legal experts.

Steps in product development

Banking and Legal experts evaluate the product and make necessary amendments to make it workable keeping in view of existing laws and policies. Hybrid documentation is prepared which encompass features of Islamic Contract law and Banking laws.

A prototype is presented to Shariah board for final review and verdict. The board finally accords the approval if the product complies with the rulings of Shariah.

In order to make a product successful it is necessary that the product should be devised within stipulated time. It is necessary that the product should be capable of implementation with fewer impediments.

People involved in the process of product development should clearly understand the problem. Shariah & Banking experts should benefit from each other's experience and knowledge to give more practical solutions to problems.

The most important factor is that the Islamic products should be clearly distinguished from the conventional products, should not give rise to any ambiguities, should be understandable and clear, easy to implement, devoid of obstacles and legally enforceable by law.

Wealth should not accumulate

Above all the injunctions of Holy Quran and Sunnah in context with the concept of ownership and wealth should not be overlooked. It is clearly mentioned in the Holy Quran that wealth should not accumulate in fewer hands and this is the most distinguishable feature between the Conventional and Islamic Banking. In order to make Islamic Banking a real success it is crucial that the Islamic products should be made available to those who are less fortunate and needy. Changes in the prevalent laws are the need of time.

The future of Islamic Banking depends on its ability to innovate. Its success will largely depend on its ability to provide variant Shariah compliant products and services at competitive pricing. The role of the contemporary Shariah scholars should be to innovate products that meet the needs of customers and be current to time. This is only possible through continuous research targeted towards the solutions to difficulties of financing in a Shariah compliant context.

The politics of the modern world have provided haven, and its economics have provided comfort. Through Islamic finance, Muslims may achieve peace of mind and the promised benefits of the life hereafter.

Islamic Banking: Achievements, Opportunities and Challenges

Dr Humayon Dar, a leading expert on Islamic finance, gave a series of seminars on *Islamic Banking and Finance: Achievements, Opportunities and Challenges* in Karachi, Lahore, Islamabad and Peshawar at the start of February 2005. It was organized by the Institute of Bankers Pakistan and was attended by senior bankers, finance professionals and others interested in the growing field of Islamic banking and finance. Dr Ishrat Husain, Governor, State Bank of Pakistan, inaugurated the series in Karachi and expressed his support for Islamic banking in the country. In the following is a brief account of Dr Dar's seminar in Karachi.

Islamic finance is integrating into the main stream finance

The last decade has witnessed a marked change in the general attitude towards Islamic banking and finance. The general apprehension has given way to adoption of Islamic finance by bigwigs in the finance industry, including (but not limited to) UBS, HSBC, Citibank and Deutsche Bank. Consequently, there is now a growing integration of Islamic finance into the mainstream finance industry and global economy. Islamic financial institutions offer a wide range of products in housing and consumer finance, business loans and project finance, designed to serve the growing market. There are now a number of Dow Jones Islamic Indexes, which track nearly 5000 companies, whose products and services do not violate Islamic Shariah.

Success stories of Islamic finance

Islamic finance is now a well-established industry, with some huge success stories at individual levels, but perhaps the most significant achievement of the industry as a whole is its contribution towards establishing what is now known as Islamic capitalism – an emerging international phenomenon combining rigour of capitalism with social concerns of Islamic economic doctrine. Islamic finance industry is now perceived as an important contributor to infrastructural development in the countries where it has a significant share of banking and finance industry. For example, Gulf Finance House – commonly known as GFH – has been involved in a number of developmental projects in the Gulf Cooperation Council countries, including the development of Bahrain Financial Harbour. Islamic banks are also involved in social welfare activities – National Bank of Sharjah (renamed as Sharjah Islamic Bank), for example, contributed millions of UAE Dirhams in the form of Zakah in the first year of its operations as an Islamic bank.

Islamic banks involved in social welfare

The positive impact of Islamic banking and finance on the communities it serves will be even more visible with the growing market size. At present, Islamic banking and finance captures significant market shares in Malaysia (around 10%), Qatar and Kuwait (20%), Sudan (30%), Saudi Arabia (15%), and UAE, Jordan and Egypt (10%). In addition to these countries, Islamic banking and finance prevails in over 70 countries, growing exponentially.

New institutions emerge

A new generation of Islamic financial institutions and umbrella organisations, which are more diverse and innovative, is emerging. Among them, most notable are Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and Islamic Financial Services Board (IFSB). Before the establishment of AAOIFI in Bahrain, there were no generally accepted accounting, auditing and governance standards for Islamic financial institutions, resulting in inconsistent accounting practices. AAOIFI has been addressing these issues since its inception in the early 1990s. Since 2002, IFSB is promoting the work started by AAOIFI. Other important institutions include Bahrain-based Liquidity Management Centre (LMC), and Labuan Offshore Capital Market in Malaysia. These institutions are taking Islamic finance into new territories that remained unexplored by more traditional players like Islamic Development Bank.

LMC active in the second-ary market

LMC is an active player in the secondary market for short-term Shariah compliant treasury products across the region, and has the capacity to arrange Islamic funds of varying risk and return profiles at different tenors. In a short span of time since its establishment in 2002, it has carved a niche for itself in the region as a strong Shariah compliant financing intermediary, facilitating the development of an Islamic interbank market.

Labuan estab-lished

Labuan, Malaysia, was established as an International Offshore Financial Centre in 1990. The island has 4000 offshore firms, including 60 banks, 50 insurance companies, and a number of trust management companies. Labuan offers a competitive Islamic offshore market for Islamic financing, Takaful and Retakaful (insurance and reinsurance), Islamic trusts, Islamic investment funds, and Islamic capital market instruments. Other Islamic products are gradually being developed in response to market needs and requirements.

Sukuk, a way to raise funds

Perhaps the most important innovation in Islamic finance in the recent past has been the emergence of Sukuk - an innovative Shariah compliant way of raising additional funding used by both sovereign and corporate bodies. They not only bring new source of funds, but are vital to developing deeper and more liquid Islamic capital markets. The international banks have been highly active in this market, with HSBC, Citigroup, UBS and BNP Paribas all involved in Sukuk issues in recent years. Qatar has issued its Sukuk and raised $700 million, Bahrain crossed the $1 billion mark in Sukuk issues, and more recently Pakistan raised $600 million.

Islamic finance to grow

Given these fast developments, Islamic finance industry is perceived as a big player not only in the Muslim world but also in Western markets in the years to come. There is a huge and growing market of 1.6 billion Muslims with a combined GDP of $1 trillion, making available substantial funds to Islamic finance. A large number of population living in some of the more populous Muslim countries, live in poor conditions. Demand for housing facilities cannot be underestimated. If an Islamic bank introduces a home finance product, tailored to meet the growing needs it would be a big success. Furthermore, providing Shariah-compliant insurance to Muslims around the world offers a huge opportunity to Islamic finance industry.

Opport-unities for Islamic banks

These huge opportunities pose great challenges to Islamic finance. With a change in the environment after the 9/11 events, there has been some movement of Arab funds to the European markets and elsewhere. Islamic banks can attract Arab money by offering attractive and competitive Islamic products. The reconstruction operations in Iraq and Afghanistan provide an opportunity and of course a challenge for Islamic banks to come forward and benefit.

Moreover, privatization of finance and industry in almost all Muslims countries offers a challenging opportunity to Islamic banks and financial institutions to capture their share of an increasing pie in the private markets. The opportunity to expand frontiers of Islamic finance is even bigger given the structural changes in conventional banking and finance. Banks are into all kinds of activities, insurance, mortgages, consumer products, blurring the distinction between commercial banking and other areas of finance.

Although a global industry by now, Islamic finance has to address a number of local issues. For sustainable growth, Islamic finance must increase awareness of Islamic financial issues, products and need for patronizing Islamic finance in the local markets. Equally important is the training and education of new personnel to work in Islamic finance industry. At present, research and development expenditure by Islamic financial institutions is a low priority. This will have to change immediately if Islamic finance is to survive in an intensely competitive environment.

Islamic financial products limited

Islamic financial engineering is thus an emergent need of the time. Looking at the menu of Islamic financial products on offer, one observes the limited choice available to Islamic investors. This can be improved by developing more innovating structures and products, combing efficiency of conventional finance with equity consideration of Islamic finance. The work on development of Islamic derivatives, options and forwards and swap contracts is at an initial stage and there is a need to speed up this process by pumping more resources in this field.

Takafol has potential to develop

As mentioned earlier, Takafol has a great potential and according to some estimates, it can surpass mainstream Islamic finance activities by miles once developed and accepted in the Islamic markets around the globe. There is a need to focus on developing this immensely important sector of Islamic finance by developing more competitive Islamic insurance products for households and businesses. Although countries like Malaysia and Saudi Arabia have taken a lead in this field, Pakistan can play an important role in this area by developing a Takafol industry as a compliment to Islamic banking.

Now that a number of Islamic financial centers have emerged in the Islamic world, notably Bahrain, Malaysia and increasingly UAE, Pakistan can play a strategic role by developing an international Islamic financial centre to attract more Islamic capital into the national economy. The recent issuance of Sukuk is a right step in this direction but a lot more is to be done to establish Pakistan as a safe haven for Islamic capital.

Pakistan needs to develop as a hub of Islamic finance

In recent years, there is an emphasis in economic policy on export promotion and attracting foreign investors into Pakistan. Given the great competition in the market, Pakistan needs to project itself as a niche market for certain investors. Islamic finance provides this opportunity that the country should grab sooner than late if it wants to regain its respect in Islamic banking and finance. Being perceived as a pioneer of Islamic banking, Pakistan has failed to capitalize on this reputation. Now that the government has officially adopted dual banking sytem, this is the right time to launch a strategy for developing Pakistan as a hub of Islamic finance.

Pakistan has played an important role by strategically placing itself in the war on terror. Now it is the time to adopt a strategy to place itself in Islamic finance if it wants to gain from exponential growth in Islamic finance. Pakistan is indeed in a much better position than many other Muslim countries to bring the West and Islam together. Islamic finance is proving to be an effective mechanism allowing the West to learn more about positive elements of Islam, and there is no better candidate than Islamic banking and finance to tell the world that Islam has much to share with the wider world.

Dr Humayon Dar is also Vice President of Dar Al Istithmar, a global provider of Shariah advice to the institutions offering Islamic financial services. He will be giving a series of seminars on "Risk Management in Islamic Banks," to be organized by the Institute of Bankers in the first week of May, 2005.

Role of State Bank in Islamic Banking

The financial sector in Pakistan has been witnessing a growing inclination for Islamic banking, as large numbers turn away from conventional banking. Not only have two separate banks been set up to meet the growing demand, but there has been an increase in the number of Islamic banking counters at major local and foreign banks in the country. According to estimates, by 2010, about 20% of conventional banking might come into the ambit of Islamic banking.

Islamic banking growing in Pakistan

Though in its infancy, there is now an Islamic banking system, which operates in parallel with conventional banking. Many who were averse to riba based banking now have the choice to invest in trade and business by availing loans from Islamic banks. Similarly, people can operate a bank account, which conforms to Islamic law.

Attempts have been made in Pakistan as far back as the early 1980s, to Islamise the banking system, but initially things did not work out because of the absence of a workable financial infrastructure and implementation of financial regulations especially relating to compliance. There has however, been a tremendous change since.

More branches being opened

Pakistan has made immense strides for the growth of Islamic banking in the country. Today there are two full-fledged Islamic banks with 23 branches operating alongwith conventional banks. 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 (SBP) is looking into it.

To provide a conducive environment for the growth of Islamic banking in the country, the State Bank of Pakistan is playing a proactive role to institute best practices legal, regulatory and accounting and provide the framework to support Islamic banks to develop. Current regulations governing Islamic banking are in line with some of the best and progressive regulations being followed in countries like Bahrain and Malaysia.

State Bank supporting growth of Islamic banks

A full-fledged Islamic banking department has been created in the State Bank that serves as a focal point for all matters relating to Islamic banking and finance in the country.

A Board comprising two scholars and three experts in the areas of banking, accounting and legal framework has been established at the State Bank to advise it on modes, procedures, laws and regulations for Islamic banking, ensuring compliance and smooth operations of Islamic banks.

A three pronged strategy

The State Bank of Pakistan has adopted a three pronged strategy, facilitating the development of Islamic banking institutions and financial products, so that they could operate in parallel with the conventional banking practices.

§ allowing the opening of fully-fledged Islamic commercial banks in the private sector

§ allowing existing banks to establish subsidiaries for Islamic banking.

§ allowing existing banks to open stand alone branches for Islamic banking.

A detail criteria for setting up of the above three has been issued for each category separately by the State Bank of Pakistan, based on Shariah principles. (details available on www.sbp.org.pk).

Banks setting up Islamic subsidiaries will see that there is complete segregation of accounts. Further, bank setting up stand-alone branches, is also required to set up Islamic Banking Division at the Head Office and appoint a adviser to advise the Islamic Division on matters pertaining to Shariah. They will take due care to ensure proper maintenance of records for all transactions and will also comply with the statutory liquidity and cash reserve requirement determined by State Bank of Pakistan.

The State Bank of Pakistan is one of the founding members of the Islamic Financial Services Board, committed to the promotion and development of international standards consistent with Shariah in order to ensure transparency in the Islamic financial services industry.

SBP and BMA

The State Bank has entered into cooperation arrangements with the Bahrain Monetary Agency in the area of Islamic banking and regulations and sukuks. The memorandum signed between the two, aims to strengthen cooperation on a number of issues, including, supervision, technical expertise and training assistance. To strengthen linkages with the global Islamic financial market, the Central Bank is also a member of the International Islamic Financial Market.

SBP plays diverse roles

As the Central Bank of the country, and regulator of policies, the SBP is called upon to play different roles — role of policy maker, a supervisory role, and a developmental role for the growth of the Islamic banking system in Pakistan.

Besides laying down the criteria mentioned above and inducting scholars, experts, lawyers, a diverse group to guide the Islamic banking industry, the SBP makes efforts to ensure that each Islamic banking institution has an audit once a year. ICAP in association with State Bank of Pakistan is developing accounting standards for Islamic modes like Murabaha, Ijara, and Musharika. The State Bank would ensure onsite inspection to check for compliance.

Islamic export refinance scheme has been developed by the State Bank for promotion of exports. Designed on the basis of Musharika between the bank and State Bank, financing to the customer can be provided in any of the Islamic modes of financing.

To enhance product diversity, spur financial innovation and support the development of the Islamic financial system, efforts are underway to develop Islamic products for liquidity requirements and for other investment purposes, which will be based on the leasing of fixed assets presently owned by the Government.

As a developer and promoter of the Islamic banking system in the country, the State Bank of Pakistan has arranged 11 video conferences in collaboration with the Islamic Development Bank. The Bank has developed special certificate courses for its officers, hired experts from Malaysia to train bankers for Islamic banking.

Certifi-cation courses deve-loped

State Bank's certification courses will help develop the human resource base in Pakistan. Lack of qualified manpower is one of the biggest hurdles in the advancement of Islamic banking. Training courses will help fill the lacuna. We need to have more Shariah advisors available, as they have a role to play in developing Islamic banking in the country. Islamic banking grew and gained strength in Malaysia and Bahrain because of their focus on strengthening the as well as enhancing intellectual capital development.

As compliance grows and the industry develops a broad range of Islamic financial products, it will be able to attract more customers into the ambit of Islamic banking.

Agriculture

Shift in agriculture sector share

Over the years there has been a change in the share of the agricultural sector in GDP and the size of labour force employed. However, it still continues to contribute significantly to the economy by providing necessary raw material to agro-based industries. Share of agro-based products to total exports is nearly 70%, being a source of income for over 45% of the people and contributing significantly to exports.

Of the total agricultural labour force, 85% are small farmers having less than 12.5 acres of irrigated land or less than 25 acres of un-irrigated land. Land is concentrated among larger farms, as the Agriculture Census 2000 shows; 56% of the total farm area is under only 14% large farms, while 44% area is under 86% small farms.

Growth fluctuates

As the agricultural sector continues to be influenced by the vagaries of nature, it has resulted in a fluctuating growth pattern. In FY04, the growth recovered to a positive 2.6% from a negative 2.2% in FY01, giving an annual average of 1.1% between 2001-04, against 2% population growth in the same period. Due to the recent rain spell the water supply situation has improved and the overall agricultural growth could be around 5%, against the target of 4%

Water situation improves

Water situation for Rabi season has improved in recent months due to wide spread rains, which is likely to have a positive impact on crops. For Kharif crop however, the availability of water was around 12% less than normal supplies and 10.3% lower over the availability during last year’s Kharif season.

According to a World Bank study, the growth in agriculture has been achieved through an increase in area rather than productivity increases. Though in the past few decades this growth has lowered food poverty in rural areas, but it has not led to widespread increases in income. It has benefited large landholders, more than small landholders and the landless. The growth in total income has not resulted in better access to health and education services for the poor in rural areas.

There is a wide gap between actual and potential yield of different crops. In respect of yield per hectare, Pakistan ranks 8th in wheat, 9th in rice, 10th in cotton, 15th in maize and virtually lowest in sugarcane despite having the largest irrigation system in the world.

Population growth pressure

Fast increasing population exerts pressure on agriculture sector to produce enough to meet the growing food and fibre needs. It is estimated that population will touch 180 million by 2010 and 280 million by 2025. This is a warning bell for policy makers. The policy makers need to devise ways and means to meet the future challenges of food and fibre through efficient utilization of available resources.

Need to increase output

To end stagnation in crop production, it requires a series of measures related to soil, water, agronomic and socio economic factors. It is imperative to increase crop production. Efforts are being made since the past three years to tackle problems related to agriculture sector and improve crop productivity.

The government is giving top priority to the development of water resources, in order to uplift agro-based economy on national level. The World Bank is keen to help Pakistan improve agricultural productivity and support the Government meet its goal of reducing poverty and improving the quality of life for the rural poor.

Wheat

Higher wheat consumption

Wheat occupies nearly 38% of the total cultivated area, contributes 12.5% to agriculture value-added and about 3% to the GDP. While the world's per capita consumption stands at around 99 kg/annum, in Pakistan it is higher.

The provincial food departments calculates it at 124kg, while the Agricultural Prices

Commission estimates it at 135kg per annum. On this basis, the government has targeted wheat requirement for 2005 at around 21 - 22 million tonnes.

Due to acute water shortage last year, production was 19.5 million tonnes – almost a million tonne short of the target. After allowing for 10% wastage, only 17.55 million tonnes were available and the shortfall was met through import of 2 million tonnes.

As against a production target of 20.2 million tonnes for the 2004-05 crop, annual consumption is a million tonnes higher, necessitating import of 1.5 million tonnes. At the national level, the area to be cultivated under wheat is targeted at 8.3 million hectares.

Water flows improve

The government is optimistic about this season's crop. It expects to achieve 21 million tonnes production, with a bumper crop expected both in Sindh and Punjab, after improvement in water flows in recent months.

Province-wise, Punjab is expected to produce 16 million tonnes, Sindh 2.5 million tonnes, NWFP 1 million tonnes and Balochistan 0.6 million tonnes. In Azad Jammu Kashmir, where production has never exceeded 0.5 million tonnes, it is expected to reach 1 million tonnes. The harvesting is due in April. While the government estimates to achieve the target of 20.2 million tonnes next season, prolonged cold spell could adversely affect the crop.

A prolonged cold spell and heavy rains could have an adverse impact on plant growth and wheat harvesting may be delayed in Sindh and Punjab. There are also reports of some damage to wheat plants in Punjab. The government however, hopes to achieve the production target.

Since July this year, the country has so far imported 1.1 million tonnes of wheat. Last year, 2 million tonnes of wheat were imported to meet the shortfall. For this year, one million tonne of import was initially planned, which was later raised to 1.5 million tonnes, mainly to stabilize wheat prices in the domestic market.

Rice

Product-ion and area targets set

The Federal Committee on Agriculture has fixed a production target of 5.114 million tonnes for this year. Province-wise targets are; 2.99 million tonnes for Punjab, 1.501 million tonnes for Sindh, 0.139 million for NWFP and 0.484 million tonnes for Balochistan.

Area under the crop was set at 2.586 million hectares. However, area sown is reported at 2.507 million hectares, 3% lower than the target but 1.9% higher over last year. The size of the crop is estimated at 4.977 million tonnes — almost 2.7% higher than last year but 2.7% lower than the original target.

New export market

Meanwhile, China, the biggest consumer of rice, has agreed to buy rice from Pakistan to meet its growing demand for the commodity. Rice Exporters Association of Pakistan is to export 50,000 tonnes of rice to China by the year-end, where Basmati and Irri-6 would be among top varieties expected to find place in the market. China could become the largest market for Pakistani rice.

Kenya levies duty

On the other hand, rice exporters are facing serious problem in exporting rice to Kenya, Uganda and Tanzania. These countries have increased import duty on rice from 35% to 75%, resulting in cancellation of export contracts for 4000 metric tonnes. Many rice importers have also held back purchase orders till the solution of this issue, which has created a confusion among importers and exporters in East African countries and Pakistan. Local prices of IRRI-6 rice have decreased from Rs.13.30 per kilo to Rs.13 per kilo after the increase in import duty in the East African countries.

The Kenyan Government has now waived CET on Pakistani rice, which had stockpiled at the

Kenyan port due to imposition of CET at the rate of 75% in January. The Kenyan Government has also waived off the customs warehouse rent for rice and other goods, which were held at the port awaiting clearance.

Pakistan looses market share

However, Pakistani exporters were unable to compete in the international market because of the high freight charges and also due to higher domestic prices. They have not received any significant fresh export orders from the African or the Middle Eastern markets. Pakistani rice is losing market share in Africa to Vietnamese rice.

Pakistan has also been gradually losing its share in the Saudi rice market because of competition, mainly from India, over the past many years. Currently 80 per cent of the total Saudi rice imports are of parboiled and basmati variety. One of the reasons for this steep decline in Pakistani share has been the gradual increase of the parboiled (Sela) rice consumption in the kingdom.

Saudis to import Irri variety

It, however, has started to export Irri-6, Irri-9 and D-98 (PK 198) brands produced in Sindh to the Saudi market. Rice exporters are negotiating with Saudi authorities for the export of 70,000 tonnes rice to the Kingdom this year. The United Nations World Food Programme has also awarded Pakistan a tender issued for the supply of 48,000 tonnes of 25% broken rice to North Korea.

During the current year, increasing inquires from the Gulf countries, a newly explored market, have lifted exporters hopes for a growth in exports of Irri-6. Its share in rice exports is expected to increase by 20 to 25% as compared to 10-15% last year. Increase in prices of several varieties in the international market has also contributed to the rise in rice exports.

Pakistan has exported 0.4 million tonnes of Irri-6 rice between October and January. In the domestic market, Irri-6 was quoted at around Rs.1,310-1,320 per 100-kg bag, while traders quoted FOB prices for Irri-6 at $238/$240 per tonne. In the international market, rice prices have softened. However, Pakistani rice exporters were unable to offer lower rates because prices still remain high in the domestic market despite a slight dip in recent weeks.

Sugarcane

Water intensive crop

Pakistan is the eighth largest cane sugar producing country in the world. Sugarcane is a highly water intensive crop. Due to shortage of water, the standing crop is experiencing low yield and sucrose content. A 12% shortage of water during kharif season has caused a decline in area under cultivation and production.

For 2004-05, the area under sugarcane crop was targeted at 1 million hectares as against 1.1 million hectares last year. However, the crop has reportedly been sown on 0.958 million hectares, 4.2 % below the target and 10.8% less than previous year.

Faces shortfall

The Federal Committee on Agriculture has targeted sugarcane production at 50.875 million tones based on provincial targets of 32.756 million tonnes for Punjab, 13.141 million tonnes for Sindh and 4.978 million tonnes for NWFP. However, overall production is being officially estimated at 47.938 million tonnes, short both against the original target and preceding year's output of 53.776 million tonnes.

Domestic sugar industry is the main user of sugarcane. At 80% cane utilization during the crushing season, the sugar mills will need 36 million tones of cane. The Pakistan Sugar Mills Association has estimated 2004-05 crop slightly lower than one given by the Federal Committee on Agriculture. At 44.6 million tonnes, it is 12.4% short of the target, 6.9% below the official estimates and 17.1% less than the previous season's crop.

Keeping in view the prevailing situation, the industry estimates that mills will be able to crush about 36 million tonnes of sugarcane by the end of the season. Domestic sugar production is expected to slip to 3.1-3.2 million tonnes in the current season, compared with 4.2 million tonnes the previous year. With consumption at around 3.6 million tonnes, production will be 20% less than last season's output and nearly 9% short of this year's requirement.

Sugar production falls

Crushing season normally starts in November and ends in March. This year, cane crushing by mills commenced in December. The crushing has already entered into the final phase, as buying of sugarcane by all mills has stopped, effective February 28. Delayed sowing was partly responsible for the loss of sucrose content.

A number of sugar mills in Sindh and Punjab have reportedly ended crushing owing to short supply. Analysts expect production between 2.7-2.8 million tonnes this season, 9.7% below the earlier estimates by the Sugar Mills Association. As of January 31, the mills had reportedly crushed 22 million tones of sugarcane producing 1.9 million tonnes of sugar.

Last season's excess production combined with a huge carry over stock of 0.6 million tonnes, and consistently lower prices of sugar in the international market forced the domestic sugar mills to sell their produce below their cost of production in the last quarter of the financial year.

Sugar imports

Anticipating a shortfall in production this season and to keep prices in the domestic market at reasonable levels, the government has allowed import of refined sugar. It also abolished import duty and withholding tax on refined/raw sugar. The Trading Corporation of Pakistan initially planned to import 1 million tonnes of white sugar. Since January, importers have reportedly imported 0.38 million tonnes of sugar, after the government scrapped 25% import duty on the commodity. Some big mills are also involved in its imports.

However, importers are of the opinion that current sugar import prices, which currently range between $285-$295 per tonne, falling from a high of $325 per tonne at end January, are not attractive. Sugar imports at current rate would have only a slight impact on domestic sugar market. In the domestic market, retail prices were approaching 4-year high of Rs.30 per kg in early February. These have however, halted at Rs.28 per kg after the decision to allow import of sugar, though it still remains on the higher side. A few months back, the retail market price was Rs.18.50 per kg. Sugar prices are not expected to come down.

Cotton

Pakistan is the fifth largest producer of cotton in the world, the third largest exporter of raw cotton and the fourth largest consumer of cotton. Cotton production supports Pakistan's largest industrial sector, comprising over 400 textile mills, 9 million spindles, 27,000 looms in the mill sector (including 15,000 shuttle less looms), over 250,000 looms in the non-mill sector.

All-time high crop

Area and production targets for the current year were 3.14 million hectares and 10.7 million bales. The crop was, however, sown over 3.210 million hectares, 2.2% more than the target and 7.4% higher over last year's 2.989 million hectares.

Prospects for this season's crop has brightened due to favourable weather conditions, increase in sown area and the combined efforts of the growers and the government to achieve a bumper harvest.

The Cotton Crop Assessment Committee in November 2004 estimated the size of the crop at 12.1 million bales against the target of 10.7 million bales and previous year's output of 10.048 million bales.

This was the second upward revision in the size of the crop made in view of increased plantation. The Federal Committee on Agriculture had earlier revised the size to 11.6 million bales against the earlier target of 10.7 million bales.

Due to bumper harvest, the crop size has been again revised to an all time high of 15 million bales, 17.2% more than the last historic crop of 12.8 million bales achieved in 1991-92.

Sindh reportedly produced a record cotton crop of more than 3 million bales. It is for the first time that the province has crossed the target of 2.4 million bales.

Record arrivals at ginneries

According to the Pakistan Cotton Ginners Association, record arrivals of seed cotton have been reported at the ginneries this season. By end- February, total arrivals stood at 14.26 million bales, of which, 11.24 million bales were received from Punjab.

The pace of arrivals has now slowed. It is hoped that another 0.3 million bales would be added by the close of the season. Final figures of production are being placed at between 14.5 to 14.6 million bales. Mills are expected to consume an estimated 14 million bales given the ongoing expansion in spinning capacity.

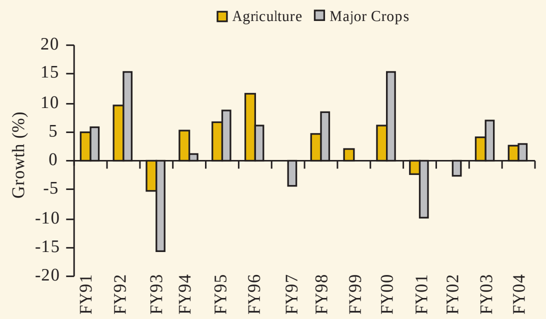
The ginners have so far pressed 14.2 million bales, of which the textile industry has lifted 11.2 million bales, the Trading Corporation of Pakistan 1.64 million bales and private exporters have purchased 0.53 million bales. The remaining 0.95 million bales are left unsold with the ginners.

This season, cotton imports are expected to be around 1.28 million bales and export shipments around 0.8 million bales. The surplus of around 0.48 million bales would be added to cotton inventory. According to reports, exporters are also selling their stocks in the domestic market fetching higher prices.

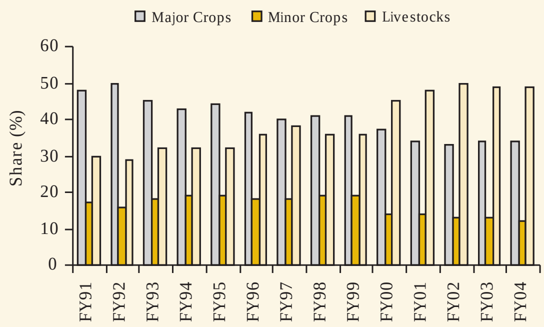
Cotton prices rise

Cotton prices have risen sharply during the past few weeks in the domestic market. Spot rates for 40 kgs is Rs.2492(ex-gin). Seed cotton prices in Sindh and Punjab currently ranges between Rs.2350 - Rs.2750 per 100 kgs depending on the quality. However, prices are expected to dampen with the arrival of the new crop in September.

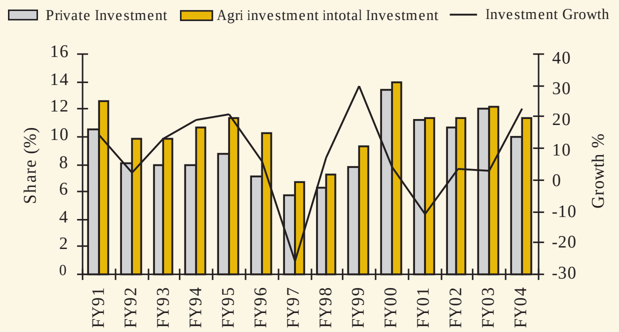
Agricultural Growth



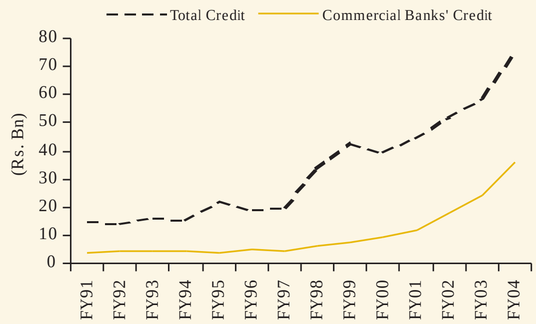
Share in Agricultural Value Added



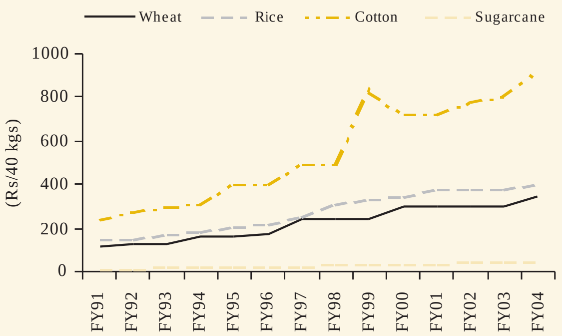
Investment in Agriculture



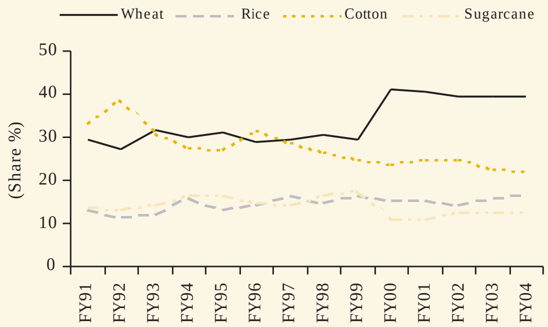
Credit-Disbursement to Agriculture



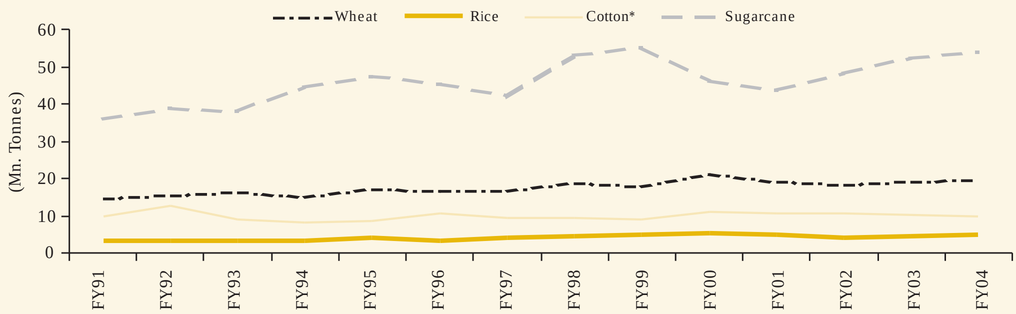
Support Prices of Major Crops



Value Added Share in Major Crops



Major Crops Production

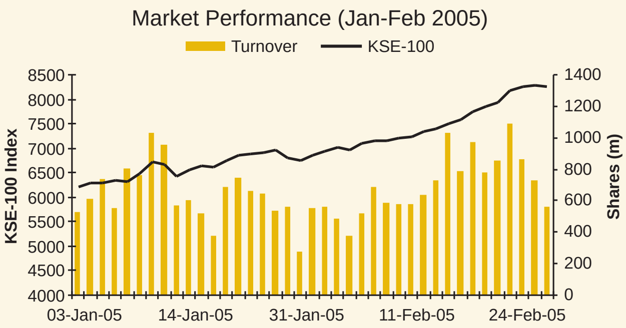


** mn. bales*

Market Analysis

Market Performance

January and February 2005 mark perhaps the most bullish period in the history of the KSE. Over these two months, the KSE-100 Index gained 2043 points or 33% to rise from 6218 to 8261. The rally was led by heavyweights in the oil & gas, telecommunications, and banking sectors, but gains were across the board with noteworthy gains in the textiles sector in particular. While January was bullish with a 529 point gain on average daily volume of 640m shares led by PTCL, February performance was phenomenal with the Index rising 1514 points in the month on average volume of almost 700m shares daily. The Index reached a new record high of 8285 points in February, and there were 6 days in which the Index closed up more than 100 points for the day, including one day when the market rose 255 points on volume of 1.1b shares. Trading was dominated by heavy punter activity, aided by momentum chasing from retail investors and foreign fund buying in select scrips.



Key Movers

Market gains were broad based but led by heavy weights in the banking, oil and gas, and telecommunications sectors. The sugar and textile sectors were also very strong movers. PTCL made strong gains on privatization related buying, its share price rose 38% in January and another 12% in February (54% during the two months).

The E&P sector was in also heavy demand during this period. OGDCL gained 57% and Pakistan Oilfields (POL) rose 32%, but the star performer was Pakistan Petroleum Limited (PPL) with a 84% increase in share price in February following the government's decision to privatize the company during the year.

Further downstream, PSO, another market heavyweight, gained 44% (33% in February alone), also on privatization related optimism.

Of the two gas companies, SNGPL came in for heavy buying and rose 29% as positive sounds were made by the relevant parties regarding a gas pipeline deal, but SSGC was neglected.

Banks were hot too, as they reported excellent full year earnings and pleased the market with bonus share offerings. The sector heavyweight, NBP, was also the best performer with a72% increase in price.

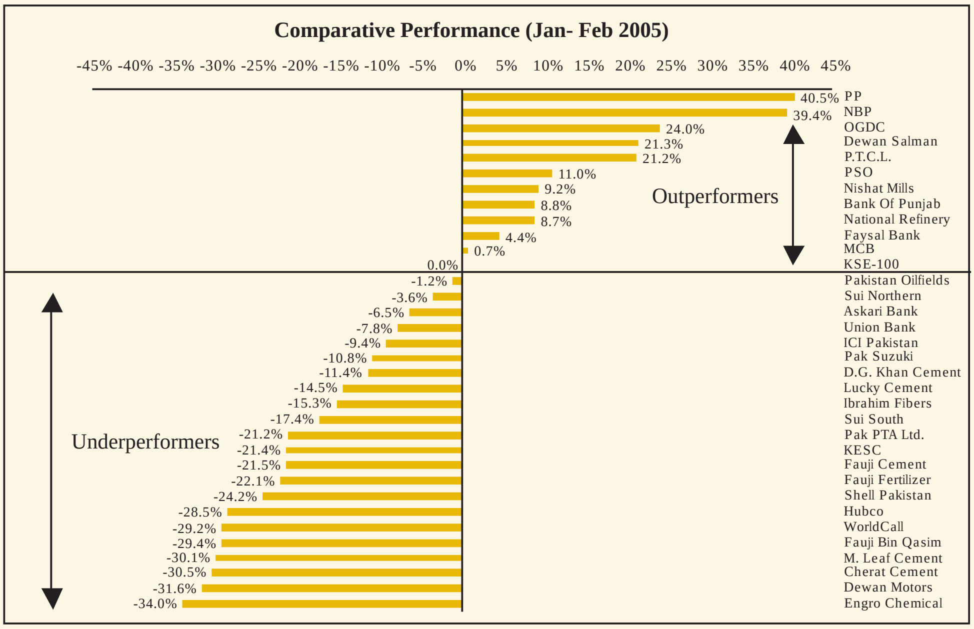
The notable under performers were the cement sector, and fertilizer stocks. There was some good performance here, but gains of 21% by DG Khan Cement, and 11% by FFC failed to stand out when compared to the gains made in oil, gas, and banking stocks.

Looking Ahead

The Index gained 57% in the 4 month Nov04-Feb05 period. The market is in the grip of a buying frenzy, and for now speculators reign supreme. Gains are being driven by privatization prospects. PTCL, PSO, NRL and PPL are all expected to be privatized in the coming months. POL is considered a leading contender for NRL and as a result has seen its share price rise sharply as well.

While reasons such as privatization and earnings growth are valid, in some cases, the market has overextended itself. The speed at which the market has risen is dangerous. While macroeconomic fundamentals are strong and argue for a rising market, the month of February effectively incorporated all (if not more than all) of the price growth that had been anticipated by fundamental analysts for the rest of the year.

The market stands ripe for a correction, but as of the start of March, a correction did not appear to be imminent. Sentiment was bullish, upward momentum was strong, and upcoming corporate events such as bonus share and dividend payouts were expected to keep investor interest high. Valuations are on the high side however and traders need to be cautious- the higher the market goes, the greater the risk of a correction.



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

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†

Source: Economic Survey 2003-04

* 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.