VISION

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

MISSION

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

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Editor's Corner

Dear readers,

While Pakistan's economy has shown a strong performance through 2002-03, reduction in poverty is taking place very slowly. Growing poverty continues to deny millions of households a reasonable quality of life vis-à-vis access to the basic facilities of water, sanitation, education and health. With population growing at 2.1% per annum, the demand for social services is gargantuan and poses a challenge to economic development and poverty reduction.

To mitigate the impact of a rapidly growing population and its concomitant demand on limited resources the government announced its Population Policy in 2002: reducing fertility, thereby, lowering population growth to 1.6% by 2012. A number of interventions will be undertaken, primarily at the district and lower levels to achieve the objective.

In late 2001, the government adopted a comprehensive strategy to reduce poverty, articulated through the Interim Poverty Reduction Strategy Paper. This provided a basis for the development of a full Poverty Reduction Strategy Paper, with full participation of civil society, and all three tiers of government, federal, provincial and local. The draft Paper has now been published.

The PRSP spelt out by the GoP is all encompassing, touching on key sectors of the economy, where each has a part to play in reducing poverty. For instance, higher growth can reduce poverty if it emanates from sectors that have greater potential to generate employment. Similarly raising incomes will not solve the problem if the basic needs, such as, primary education, preventive healthcare, and population welfare services, are not tackled.

Reducing high debt payments would leave resources to be spent on investment in human resources, a comprehensive export development strategy would improve employment opportunities, governance reforms would improve public delivery, and improved public finances through raising revenues and reducing losses of public sector enterprises would release sufficient fiscal space for increased spending on social uplift and infrastructure development. Strengthening of the regulatory framework as part of financial sector reforms would increase the ability of the banking system to weather financial shocks, strengthen their capacity to extend credit at lower cost, reduce the direct role of the government and foster good governance. Sustained pro-poor economic growth based on robust private sector activity is an important facet of the poverty reduction strategy. All sectors have been opened to foreign and domestic investment. In short, for results to endue a greater participation by all at all levels is essential.

During the past two years, since the I-PRSP was initiated, much headway has been made in all but a few areas. The quantitative performance criteria have on most counts been met; the fiscal deficit plan is paying dividends; monetary programme remains geared towards maintaining low inflation; and there has been an increase in social sector spending. Shortcomings have been observed in the power sector, as the financial performance of both WAPDA and KESC was poor, and investor interest has been weak and the level of investment has not picked up.

The draft PRSP is a more comprehensive strategy, building upon the past policies and taking some steps which are in addition to those already taken in the I-PRSP. It recognizes the central role of the provinces and local governments in achieving human development goals. Some of the new issues it tackles, includes, among others, rural development, gender and environment. In the rural sector programme, fisheries, livestock farming and rural electrification alongwith water storage and management programme receive emphasis. Gender equality and empowerment of women is being mainstreamed.

In the trade sector emphasis is on enhancing exporters profitability and on inducting a larger number of new and emerging exporters, while in the public finance area, a Fiscal Responsibility Law will soon be enacted. Plans are also afoot to reduce losses of public sector enterprises, and these should be implemented with vigour. While the housing sector continues to receive mention, it is the financial sector, which is being encouraged to provide loans to stimulate growth. Under the social safety nets programme, a new proposal in pension provision suggests changing to a system, which has universal coverage. A new scheme titled Pensioners Benefit Account for pensioners has been launched.

The government's effort towards poverty reduction receives support from the IMF, with the World Bank complementing the Fund's work through support to structural reforms in the social sectors and support of the growth agenda through deregulation of key sectors such as power, oil & gas and banking. The Asian Development Bank supports the Funds activities in improving Governance through its Devolution Support Programme and the Judicial Reforms Programme.

One hopes that by adopting this approach towards poverty reduction, one would in the near future see an improvement in the human development index. However, unless these are accompanied by system-wide institutional, systems and procedures (modus operandi) re-engineering, success would remain limited.

Ayesha Mahmud

Abstract of the Bulletin

Federal Budget 2003-04 – A Review

§ The Federal Budget 2003-04 has a total outlay of Rs.805.2 billion, marginally higher than last year's revised expenditure of Rs.804.9 billion. Current expenditure has been brought down by 4.2%, while development expenditure has been raised by 21.5%.

§ Tax receipts are to rise by 11.1% to Rs.510.0 billion, from revised estimates of Rs.458.9 billion, because of enhanced sales and income tax expected in FY04.

§ Against a revised fiscal deficit of 4.5% of GDP in FY03, the budget for 2003-04 envisages a deficit of 4.0% of GDP.

§ Budget has raised allocations for poverty related expenditure to Rs.185 billion from Rs.161 billion in FY03.

§ Housing, infrastructure, SMEs, port development, agriculture and water sector, social sectors receive priority.

Provincial Budgets 2003-04 Highlights

§ Sindh, NWFP, Punjab and Balochistan in their provincial budgets for 2003-04 emphasise development of education, healthcare facilities, infrastructure, irrigation among others.

§ An increase in salaries and pension of government employees has been announced.

Pakistan's Economy – 2003-04

§ Pakistan's economy performed well in FY03, with major economic indicators showing positive developments.

§ GDP growth at 5.1% was higher than the target. Agriculture, manufacturing and services growth surpassed previous year's figure.

§ Exports at $11.1 billion and imports of over $12 billion exceeded the year's respective targets.

§ Foreign exchange reserves crossed $10 billion and home remittances are expected at $4 billion. Inflation remained subdued and public debt was brought down.

The WTO Agreement on Financial Services

§ The World Trade Organization Agreement on the financial services sector came into force in March 1999.

§ Members to the Agreement have set out specific commitments.

§ The Agreement has wide ranging implications.

Agriculture

§ After two years of decline, agricultural sector staged a recovery and grew by 4.1% in FY03.

§ Major crops performed well due to improved water availability.

§ Output of wheat, rice and sugarcane exceeded preceding year's harvest, while cotton crop declined due to pest attack and shortage of irrigation water.

Banking and Finance

§ Key monetary indicators — deposits, advances, investment, notes in circulation and approved foreign exchange rose in the week ended June 28, 2003 over end March figure.

§ Credit Plan 2003-04 envisages monetary expansion of Rs.230 billion or 11%.

§ Last year monetary expansion was 16.4%.

Market Analysis

§ May and June 2003 saw the market reach new peaks in what were largely speculative movements. Certain sectors appear to have reached dangerous levels – in particular the cement sector – and by June end a correction was overdue.

§ A valuation gap has emerged between blue-chip stocks and second-tier scrips which is not sustainable. Investors should reduce exposure to the market and focus only on blue chips.

Federal Budget 2003-04 — A Review

The Federal Budget 2003-04, is part of a three year macroeconomic framework 2003-06. The framework sets out goals for major economic variables of the country, providing the yardstick to compare the performance for each year.

The economic policies pursued during the last three years have been strengthened and meeting stabilisation goals continue to receive emphasis. Some formidable challenges — like raising the level of private investment, accelerating and sustaining the growth rate, stepping up spending on human development, containing the losses of public sector enterprises and improving upon the existing infrastructural facilities have to be tackled.

The following are brief comments on some aspects of the Federal Budget 2003-04.

Revenues Envisaged to Increase

The Government of Pakistan (GoP) is targeting total revenue receipts to grow by 3.8% to Rs.728.37 billion in FY04, over last year's revised estimates of Rs.701.58 billion. The increase will accrue primarily through enhanced tax revenues, unlike FY03, when the rise in revenue receipts was on account of a 14.3% jump in non-tax receipts and an increase in surcharges.

Targets not revised

It is worth mentioning that the tax collection target was not revised during the year 03, unlike previous years, when downward revisions had to be made. However, 2002-03 experienced a shortfall of Rs.1.7 billion, on account of lesser income, sales and excise duty collection. The drop in income tax and sales tax collection was made up by the substantial rise in customs duty.

Customs duty increase

Increase in imports, particularly those imports which are subject to high tariff rates and levy of import duty on POL products account for the bulk of the increase in collection from customs. The decrease in income tax receipts was due to reduction in corporate tax rates, abolition of some withholding taxes and 35% rise in refunds during the year.

Surcharges increased over the budgeted amount as large arrears (Rs.5.7 billion) accrued and there were some upward revisions on gas and petroleum rates, carrying with it the rigours of indirect taxes. This year, surcharges have been budgeted at Rs.61.1 billion

Federal Government Revenue Receipts

(Rs.Bn)

	2002-03 BE	2002-03 RE	2003-04 BE
Total Revenue Receipts	674.89	701.58	728.37
Tax Revenue	460.60	458.90	510.00
Direct Taxes	148.40	145.00	161.10
Income Tax	143.20	138.80	154.20
Other Taxes	5.20	6.20	6.90
Indirect Taxes	312.20	313.90	348.90
Customs	56.50	69.60	78.10
Excise	50.00	46.50	47.70
Sales Tax	205.70	197.80	223.10
Surcharges/Levies	60.50	66.88	61.14
Natural Gas	15.00	15.28	15.00
Petroleum Levy	45.50	45.83	46.14
Arrears	0	5.77	0
Non-Tax Revenue	153.79	175.79	157.24

BE: Budget Estimates
RE: Revised Estimates

Source: - Federal Budget Documents 2003-04

Tax revenues to increase

The GoP in the budget 2003-04 is aiming to raise tax revenue receipts by 11% to Rs.510 billion. These higher receipts come from enhanced income and sales tax, and customs duty. Indirect taxes, including surcharges are estimated at Rs.410 billion or 71.8% of the total (taxes+surcharges). Direct taxes constituting 28.2% of total are budgeted at Rs.161.1 billion. A higher amount is expected to be realized, despite the decline in the rate of tax on taxable income of banking companies, private companies and rationalisation of the rates of withholding taxes.

As sales tax net has gradually widened to wholesalers, importers, retailers and ship breakers, it is expected to generate Rs.223.1 billion, 12.8% higher over the revised figure of 2002-03. Last year's decline under this head was due to restoration of exemption on medicines and significant refund claims which had accumulated.

Customs duty to grow

Customs duty is expected to show an increase of Rs.8.5 billion, as economic activity picks up leading to higher imports of machinery, iron and steel, chemicals and other items.

Non-Tax receipts increased

In 2002-03 revised estimates, the non-tax revenues increased by 14.3% to Rs.175.8 billion over the budgeted figure of Rs.153.8 billion. The jump in receipts from defence (Rs.56.3 billion against the target of Rs.20.9 billion) offset the Rs.20 billion shortfall in receipts from State Bank of Pakistan and Rs.5 billion fall in interest income.

In the budget 2003-04, non-tax revenues are budgeted at Rs.157.2 billion, 10.6% smaller over preceding year's revenues, on account of lower receipts from civil administration.

Higher Expenditure Outlay

The GoP has raised the size of the budget 2003-04 to Rs.805.2 billion; current expenditure Rs.645.2 billion and public sector development programme Rs.160.0 billion.

Federal Government Expenditures

(Rs.Bn)

	2002-03		2003-04
	Budget	Revised	Budget
Current Expenditure	607.9	673.3	645.2
Development Expenditure	134.0	131.6	160.0
Total Expenditure	741.9	804.9	805.2

Source: Federal Budget Documents 2003-04

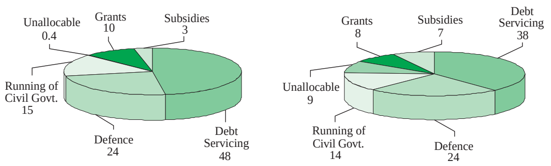
Rise in current expenditure

In the revised budget estimates for 2002-03 expenditures rose by 8.5% to Rs.804.9 billion, against the budgeted outlay of Rs.741.9 billion, primarily because of a rise in current expenditure. These exceeded budgeted amount by 11% despite a decline in debt servicing. Under current expenditure, there was a large jump in unallocable (Rs.55.3 billion), rise in defence spending (Rs.14.1 billion) and Rs.29.0 billion increase in subsidies, which were given to WAPDA and KESC. Interest payments declined by 13.5%, because of substitution of high cost short term foreign loans with low cost long term concessional assistance and lower

Current Expenditure

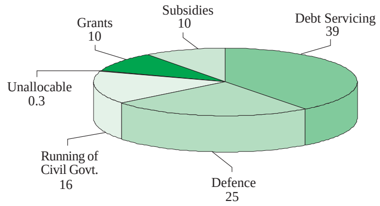
Budget 2002 - 03

(%)



Budget 2003-04

(%)



interest rates in the domestic market. Decline in interest payments on foreign debt was much more pronounced than on the domestic debt.

For 2003-04, current expenditure is budgeted to decline by 4.2%, to Rs.645.2 billion against Rs.673.3 billion a year earlier. Higher allocation (8.6%) is made for the running of civil administration and 29.6% more has been allocated for subsidies, especially for offsetting the liabilities of public sector enterprises.

Larger PSDP

Revised development expenditure in 2002-03 was Rs.2.4 billion less than the budgeted figure of Rs.134.0 billion. The public sector development programme 2003-04 is budgeted at Rs.160 billion, 21.5% more over the revised estimates for last year. With higher revenues expected during the year, there appears no reason for cuts on grounds of resource constraint.

During the year, the government plans to increase the allocations for social sectors, (especially education and health), for infrastructural development and for agriculture and water sector. Agriculture in the recent past has suffered from prolonged drought, adversely affecting the incomes of thousands of farmers. Unless such development programmes are undertaken, which provide job opportunities, poverty in Pakistan would continue to grow.

Financing of the Budget Deficit

For 2003-04, the fiscal deficit is targeted at 4.1% of GDP, as the government makes efforts to net in more through administrative reforms of various taxes and containment of expenditure. Last year's reduced fiscal deficit of 4.5% is partly due to large fiscal space made available because of lower cost of debt servicing flowing from debt re-profiling, lower interest rates and higher tax collection. Pakistan's fiscal position has improved and the deficit has shrunk from a high of 7% in 2001-02.

The reliance of this year's budget continues on external resources, though its proportionate share has come down from 58.2% in 2002-03 to 50% currently. While the government retired Rs.33 billion to the banking sector in 2002-03, it expects to borrow nearly Rs.28 billion this fiscal.

Financing of the Budget Deficit

(Rs.Bn)

	2002-03 BE	2002-03 RE	2003-04 BE
Overall Fiscal Deficit	(-)162.5	(-)181.3	(-)179.1
As % of GDP	4.0	4.5	4.1
Financing of the Deficit			
Non Bank Borrowings	52.5	98.7	59.7
Net External Resources	129.1	105.6	89.4
Bank Borrowings	(-)31.1	(-)33.0	27.9
Privatisation Proceeds	12 0	10 0	10 0

BE Budget Estimates
RE Revised Estimates

Source: Federal Budget Documents 2003-04

Poverty Related Expenditure

Pakistan lags behind countries with comparable per capita income on a number of social indicators. Though its growth has been much more than many other low income countries, the benefits have not trickled down. Government efforts through expenditure on social indicators have fallen short of requirements.

Expenditure enhanced

The Budget 2003-04 has raised allocations for poverty related expenditure from Rs.161 billion to Rs.185 billion. The amount would be spent on education, health, water supply and sanitation, population planning, development works, initiation of small public works, raising subsidy under Food Support Programme, priority to projects in the agriculture and water sectors. This would help in improving available social facilities and generating employment for large numbers.

The poverty reduction programme that Pakistan is pursuing since the last two years, would receive a boost through the enhanced allocation in this year's Budget. Care is nevertheless needed to ensure that higher development expenditure translates into better public service delivery.

The government's poverty reduction strategy has identified agriculture, small & medium enterprises, IT and energy to lead to the revival of economic growth. This year's Budget allocates Rs.17 billion to agriculture and water sector. Emphasis has been laid upon dams, new sources of irrigation, drainage and rehabilitation of irrigation system. Zarai Taraqiyati Bank of Pakistan is being restructured to facilitate the farmers.

The SME sector which has the ability to spur pro-poor growth and absorb the manpower also receives mention. The government is working with the commercial banks to open special window for providing financing to the sector. The SME Bank will be further reducing its cost of financing to give impetus to demand for SME financing. Also the SME Bank is being geared to play a major role in the development of the SME sector.

Housing Sector Receives Emphasis

The housing sector has remained more or less neglected in the past. Provision of adequate housing facilities is an integral part of any meaningful programme of social and economic development, as it is a basic human need. Low rate of housing growth, alongwith a higher population increase has resulted in large housing shortages, which have grown over time. It is estimated that there is a housing shortfall of 5.38 million units.

Given its backward and forward linkages, the Budget 2003-04 has provided incentives for the sector. The debt-equity ratio has improved from 70:30 to 80:20, the per party limit has been raised from Rs.5 million to Rs.7.5 million, House Building Finance Corporation will be providing housing loans to all government employees, federal/provincial governments would be providing new lands for housing schemes, provincial governments have rationalized stamp duties and registration fees on transfer and acquisition of housing property etc.

Availability of financing by the banks at affordable costs could go a long way in giving a boost to construction activities. If housing activity picks up, the ancillary industries and businesses involved in house construction will receive a boost and many will find employment.

Conclusion

While revenue collection is expected to increase, in 2003-04, with tax revenues growing by 11%, it would be of interest if there is an improvement in the tax/GDP ratio which hovers at around 13%. Higher development expenditure of Rs.160 billion, would have a meaningful impact only if it translates in employment generation.

Only if the government is able to create an investor friendly environment, free of political uncertainties, where the necessary infrastructure is available, where cost of capital is at competitive rates and other factors that influence investor decision are favourable, can there be any meaningful improvement in investment levels.

Highlights of Budgetary Measures

The Year 2002-03 in Review

- § GDP increased by 5.1%.
- § Foreign exchange reserves reached $10.5 billion, equivalent to finance eleven months of imports.
- § Exports of over US $11.0 billion achieved.
- § Workers' remittances likely to be $4 billion.
- § Fiscal deficit contained at 4.6% of GDP.
- § Inflation remained at 3.3%.
- § Investment has reached 15.6% of GDP.
- § Foreign direct investment touched $700 million.
- § Debt to GDP ratio brought down to 90%.
- § Bank loans for the private sector have reached Rs.120 billion, compared to Rs.37 billion last year.

Three Year Macro Economic Framework 2003-06

- § Current Federal Budget is part of a three year macro economic framework.
- § GDP to grow 6% by FY06.
- § Investment to GDP ratio to reach 18%.
- § Fiscal deficit to be brought down to 3% of GDP.
- § Foreign exchange reserves to remain minimum equivalent to 28 weeks of imports.
- § Current account deficit to be contained at 1.8% of GDP.
- § Inflation to remain at 4% throughout the period.

Poverty Reduction Measures

- § Expenditure on poverty related activities increased by 20% to Rs.161 billion in 2003-04.
- § Steps taken in the development programme to reduce the widening social gap.
- § Allocations for education enhanced by 80%, while a 20% rise is envisaged for health.
- § A new programme of small public works initiated to provide employment opportunities and also to augment the income of the poor.
- § Under the Food Support Programme, the subsidy given to the poor has been raised from Rs.2000 to Rs.2400.
- § Raising development budget by more than 30%, should create significant employment opportunities.
- § Small and Medium Enterprise (SME) Bank being made more proactive.
- § The reach of Khushali Bank being increased.

Development of the Housing Sector

- § State Bank of Pakistan introduces changes in the regulatory environment:
  - Per party limit raised to Rs.7.5 million against Rs.5 million.
  - Exposure limit increased from 5% to 10% of net advances.
  - Maximum loan period enhanced to 20 years from 15 years.
  - Debt equity ratio raised to 80:20 against 70:30.
- § Foreclosure law amended, allowing banks to repossess the property without recourse to Courts.
- § House Building Finance Corporation to provide loans to all government employees.
- § Provincial governments rationalizing stamp duties and registration fees on transfer and purchase of property to minimize the financial burden on owners and encourage documentation.
- § New lands to be provided for housing schemes.

Pay and Pension Reforms

- § Salaries of government employees raised.
- § Pension to be increased.
- § Special saving schemes available for retired pensioners, will also be made available for widows.

Tax Reforms

Income Tax

- § Tax rebate on mark up upto an amount of Rs.500,000 or 40% of the income, whichever is less, would be given to those individuals who construct their houses through bank loans.
- § The rate of withholding tax on property income reduced from 7.5% to 5%.
- § The new income tax law proposes to eliminate 20 exemptions that are presently available.
- § Wealth tax law has been repealed.
- § Income tax regime being rationalized. This year there will be a reduction for private companies @2% and for banking companies @3%.

Customs Duty

- § Fully automated clearance system introduced, which will reduce the clearance time from an average of eight days to within 48 hours.
- § 10% customs duty on imported oilseeds to be replaced with 20% sales tax.
- § Rate of duty on 112 items used in specific key industries like heavy engineering, light engineering, fans and ceramics to be reduced.
- § Rate of duty on vehicles of 1800cc and above reduced from 200% to 150%.
- § Rate of duty on smuggling prone items like tea, spices, silk yarn reduced.

Excise Duty

- § Existing excise duty of 5% on paper and board to be abolished.
- § 10% excise duty on wires and cables is being abolished.
- § 25% reduction in excise duty on cement.

Sales Tax

- § Through an amendment in law, sales tax audit in future would be conducted once a year and audit report would be shown to the tax payer.
- § For settlement of past liabilities, all business persons who get registered upto September 20, 2003, and pay turnover tax @2% only for one year, no questions would be asked about past liabilities.
- § As further relief, the rate of additional tax has been reduced from 2% to 1% and the rate of penalty on delayed filing from Rs.5000 per day to Rs.100 per day.
- § To facilitate small tax payers, the ceiling of minimum turnover liable for tax increased from Rs.2.5 million to Rs.5 million, whereas for wholesalers, this limit has been raised from Rs.5 million to Rs.20 million.

Provincial Budgets 2003-04
Highlights

Sindh

- Revenue expenditure budgeted at Rs.89.54 billion, while revenue receipts are projected at Rs.90.91billion.
- Total development outlay planned at Rs.14.73 billion.
- Federal transfers to finance large part of the budget.
- Higher allocation for public sector development programme to create 24000 new jobs.
- Priority would be given to 400 on-going schemes, which are at an advanced stage of development.
- A 15% increase in the salaries and pensions of government servants.
- Tax relief provided to widows, minors, orphans and disabled persons and provincial servants who are property owners. Limit of tax exemption raised from Rs.10000 to Rs.24000 gross annual rental value.
- Property tax halved for educational institutions, hospitals, clinics, and dispensaries.
- Adjustments made in stamp duty rates on property transactions.
- Property tax being devolved to Taluka level.
- The Sindh Provincial Cooperative Bank being restructured.
- Relief provided to people residing in calamity hit areas.

NWFP

- Current revenue receipts envisaged at Rs.51.5 billion.
- Current revenue expenditure budgeted at Rs.47.11 billion, showing a surplus of Rs.4.3 billion.
- The Annual Development Programme involves a total spending of Rs.14.6 billion.
- The development programme would be financed through a provincial contribution of Rs.5.4 billion and foreign component of Rs.9.3 billion.
- Major receipts include, the provinces share in federal divisible taxes (Rs.24.4 billion), profit from hydel power generation, GST on services and royalty on oil and gas.
- The province's share in the profit from the sale of hydroelectricity from Tarbela stands at Rs.6 billion, against Rs.7 billion a year earlier.
- To receive priority are, education and healthcare facilities, women development, provision of clean drinking water, construction of roads and development of infrastructure.
- Salaries and pensions of retired government employees has been raised by 15 %.
- For the socio-economic uplift of the province, functioning of government departments would be improved, so also the service delivery system.
- A separate medical college for women to be established.
- Bank of Khyber to give 25% of loans under the microfinance scheme to women.

Punjab

- Total outlay of Rs.159.7 billion; Revenue expenditure of Rs.129.2 billion, and Annual Development Programme of Rs.30.5 billion.
- Revenue income estimated at Rs.149.4 billion, which after meeting the revenue expenditure leaves a surplus of Rs.20.2 billion. Inclusion of net capital receipts of Rs.1.9 billion, raises the surplus to Rs.22.01 billion.
- Maximum allocation made for the timely completion of on-going schemes.
- The ADP emphasises, education, irrigation, roads, agriculture, water supplies, and health among others.
- Motor vehicle tax increased on different categories of vehicles.
- Rate of stamp duty reduced.
- Importers and exporters brought in the ambit of Professional Tax.

Balochistan

- Total outlay budgeted at Rs.34.83 billion; Rs.25.53 billion current revenue expenditure and Rs.9.30 billion development outlay.
- Revenue receipts estimated at Rs.24.65 billion, comprising of federal receipts of Rs.23.11 billion and provincial receipts of Rs.1.54 billion.
- The budget shows an overall deficit of Rs.2.47 billion.
- No new taxes have been imposed.
- Education upto matric has been made free in the province to facilitate the children of the poor.
- The public sector development programme lays emphasis on health, agriculture, communications especially the development of farm to market and village linking roads, water resource development, education among others.
- Salaries and pensions of government employees and pensioners increased by 15%.
- Balochistan Bank to be set up.

The WTO Agreement on Financial Services

WTO covers financial services

The World Trade Organization (WTO) Agreement on the financial services sector (banking, leasing, insurance and other financial services) were concluded in December 1997 and came into force in March 1999. A main result of the agreement was that government measures affecting trade in financial services became subject to the multilateral rules of the WTO's General Agreement on Trade in Services on a permanent basis, rather than the previous interim basis.

The General Agreement on Trade in Services (GATS) was one of the major achievements of the Uruguay Round and now forms an integral part of the World Trade Organization's legal framework. The GATS covers all service sectors, including financial services.

As it applies to financial services, the GATS consists of three components.

How does GATS apply to financial services

First, there are the general GATS obligations, which apply to all Members and to all service sectors.

Second, the GATS *Annex on Financial Services* modifies some of the general GATS rules and definitions to take into account the special characteristics of the financial sector.

Third, the individual Member schedules set out specific commitments regarding market access and national treatment provided to foreign financial service providers.

Further detail on some of these key features of the GATS is provided below:

- *Most-Favoured-Nation treatment*: There can be no discrimination between financial services suppliers from WTO member countries.

- *Domestic Regulation*: For those financial services listed in a Member's Schedule of Commitments, and where any authorizations are required for the supply of a service (e.g., a stockbroking license), authorizations must be made within a reasonable period.

- *Prudential carve-out*: Under the GATS *Annex on Financial Services,* Members shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policyholders or persons to whom a fiduciary duty is owed by a financial services supplier, or to ensure the integrity and stability of the financial system.

- *Market Access*: For those financial services specified in a Member's schedule of commitments, Members cannot take specific measures which would restrict market access unless these restrictions are clearly spelled out in the schedule.

- *National Treatment*: For those financial services specified in a Member's schedule of commitments, discrimination between domestic and foreign suppliers of financial services is permitted only to the extent that it is clearly spelled out in a Member's schedule of commitments.

In general, the GATS obliges participants not to discriminate between foreign suppliers, or between foreign and national suppliers, unless specific reservations have been made. It covers both internal and external liberalisation of members financial sectors in four different 'modes' of services supply.

These are: Mode 1 (cross-border supply) – product (services) crosses a national frontier. This category includes the taking of a loan or the purchase of insurance cover by a domestic consumer from a financial institution located abroad. Mode 2 (consumption abroad) – the freedom for the Member's residents to purchase services in the territory of another Member. The purchase of financial services by consumers while travelling abroad falls in this category. Mode 3 (commercial presence of a supplier of one member in the jurisdiction of another member). It is a situation in which a foreign bank or other financial institution establishes a branch or subsidiary in the territory of a country and supplies financial services and Mode 4 relates to labour movement in connection with the provision of financial services.

In recent years, governments the world over have moved to open up and deregulate many aspects of their financial sectors. At the same time, technological advances in telecommunications have radically changed the way financial services are delivered across borders – breaking down national barriers and shrinking distances and time. These forces have combined to transform the financial sector from a predominantly local to global industry.

Pakistan has stated in the schedule of specific commitments in financial services that its commitments laid down in the schedule are subject to the availability of similar commitments from large number of countries of significance to Pakistan. The schedule covers the financial services categories of (a) insurance and insurance related services (b) banking, leasing, asset management, financial and investment advisory services. Pakistan does not consider itself to be prevented from adopting or enforcing non-discriminatory measures aimed at protecting the soundness and integrity of the banking system.

Pakistan has emphasized that the principal of reciprocity would be the guiding line in negotiating exemptions in the trade in services. It has found that the GATS allows the capital of developed countries through mode (3) greater market access in the developing countries, while market access to the labour of developing countries through mode (4) is restricted.

Implications of Financial Services Liberalisation

§ Opening up of domestic financial markets to competition is likely to improve financial expertise in the sector itself. Foreign financial institutions that enter into local partnerships, with or which acquire local companies will have both the ability and the incentive to train local staff and provide the know-how considered necessary for their own foreign operations.

§ Market opening will also increase the need for improvements in corporate governance in order to enable domestic institutions to compete effectively. This will, in turn, promote financial stability. The transfer of new skills to the domestic sector, through the presence of foreign players can help disseminate better risk management practices, with an equally positive effect on stability.

§ Liberalisation increases the efficiency of a country's financial system and encourages its development. It stimulates wealth creation by providing easier and more varied access to capital on competitive terms.

§ The presence of foreign participants in the market will stimulate the domestic industry, providing local enterprises with access to additional resources, including foreign investment and expertise. Domestic providers of financial services having the knowledge of their own markets gives them a distinct advantage.

§ Opening up of financial services can help countries build more robust and efficient financial systems by introducing international practices and standards.

§ Evidence also shows that increased competitiveness enhanced through financial sector openness spurs economic growth. The number of foreign entrants in the market has a positive effect on the functioning of national banking markets. Increased competition may imply a reduction in domestic bank profits, but banking customers gain through reduced net interest margins, lower cost of fee-based services and the availability of a greater variety of services.

§ Experience shows that it is vital to strengthen the supporting institutional framework; this is particularly true of the regulatory and supervisory functions of the state but it also applied to the use of the market in disciplining financial institutions.

§ Financial services liberalisation will help strengthen the financial infrastructure of the economies. Necessary incentives to promote needed prudential and regulatory policies will be created.

§ Liberalisation of financial service markets, would lead to the elimination of some traditional policy instruments. In many countries directed lending for social, regional or industrial policy reasons has been fairly common. Many a time, authorities appeal for remedying insufficient access to financial markets for small and medium sized enterprises, the reduced flow of capital to backward regions. In a closed market, there are established channels of influence between financial institutions and the authorities, but as new entrants arrive this may prove difficult.

§ Opening of foreign markets would also prove beneficial for Pakistani banks desiring to set up branches in the commercial centres of its trading partners. For instance, bank branches could be set up in Malaysia, Kuwait, UAE, China, among others.

§ Open to greater competition, the local banks will have to gear towards meeting the new challenges. Industries to be extended credit must in the not too distant future conform to the required international standard of safety, and environment related issue. They should preferably be ISO certified units.

§ As foreign service providers would operate on purely commercial lines it would adversely affect the viability of the national services providers to compete with them, while they are obliged to bear the costs under social oriented policies. For example, nationalised commercial banks and development financial institutions operate many targeted credit schemes which allow concessional credit to specific sectors of the economy. These banks and development financial institutions are operating branches in rural areas which are not so attractive as those in urban areas. The foreign banks would not participate in such activities and would prefer to operate in high profit areas.

§ Banks in Pakistan could arrange to provide technical assistance to their clients to attain ISO 9000 and where applicable ISO 14000 certifications. This would ensure the basic entry requirement for future international trade under the WTO framework.

Pakistan's Economy – 2002-03

Key indicators show positive growth

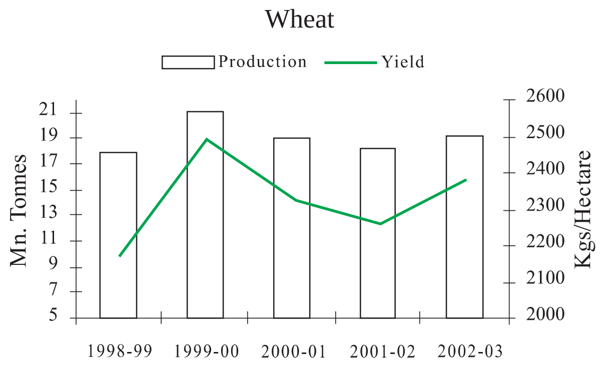
In the outgoing FY03, the performance of the economy was credible, with major economic indicators showing positive developments; higher GDP growth, low inflation, reduced fiscal deficit, foreign exchange reserves at all time high, rising workers' remittances, pick up in foreign direct investment, recovery in agriculture, improved performance at the Karachi Stock Exchange, larger exports, surplus in current account and a conducive interest rate environment. The success was however, tainted by low levels of investment, rising poverty and poor social indicators. The government is aware of these lagging indicators and efforts are being made to distribute the benefits of growth to wider segments of the population and improve the investment environment.

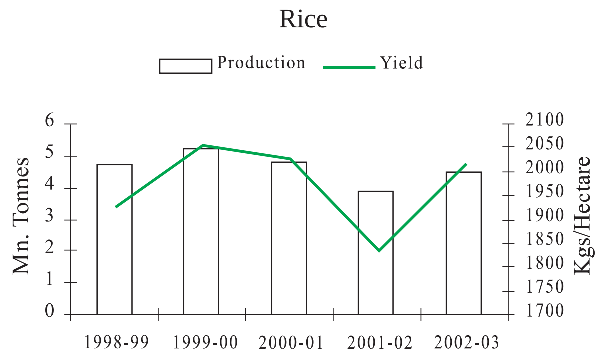
Impressive growth

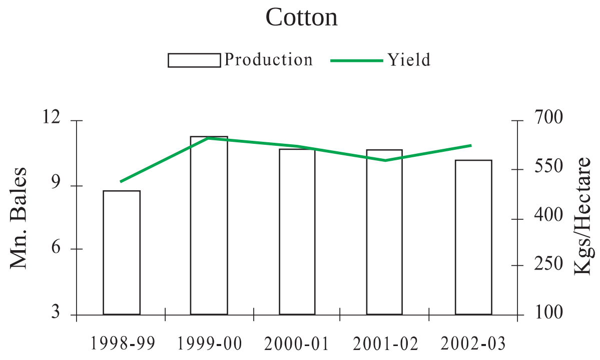
The economy performed well in the outgoing FY03, the 5.1% growth in GDP was supported by better performance by agricultural, industrial and services sectors. The GDP growth surpassed the target of 4.5%. The recently released third quarterly report for the year 2002-03 of the State Bank of Pakistan says "it appears that a part of the above target growth is simply a function of prior year adjustments that altered the base for the FY03 growth." Even after adjustments, while the growth comes down slightly it is still above the target, reflecting the improvement in the economy.

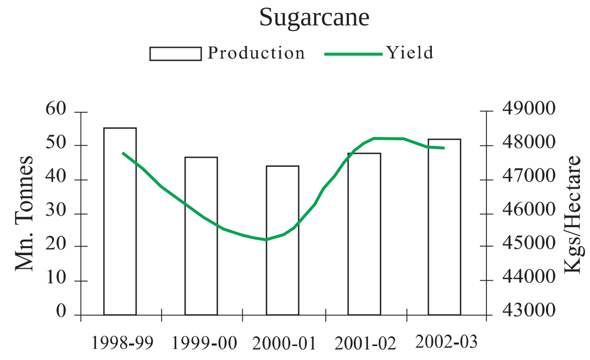
Agricultural performance improves

The prolonged drought which had adversely affected agricultural performance in the past two years, subsided in FY03 as good rainfalls helped push water availability. The agricultural sector grew by 4.2% against a decline of 0.1%. Last year the crops sub-sector recorded positive growth due to higher per hectare yield. The later was the result of improved water availability and relatively higher prices of preceding crops which encouraged increased use of agri-inputs. Production of wheat, rice and sugarcane increased in FY03, while cotton recorded a lower output due to pest attack and shortage of irrigation water.









Manufacturing growth picks up

Manufacturing performance improved in the outgoing FY03, as growth at 7.7%, surpassed preceding year's figure of 5.0% and the 5.8% target for the year. The improvement was brought about by the broad based growth of 8.7% by the large scale manufacturing, attributable primarily to improved economic environment, rising demand for consumer durables, improvement in construction activities, and expansion in exports of manufactured goods.

In the large scale manufacturing sub-sector, the growth is led by textiles and sugar, which together constitute 28% of value added and have grown at 5.2% and 12.4% respectively. The increase in production of automobiles was most impressive. The various loan schemes by commercial banks and leasing companies remains the major contributor to strong sales of cars and motorcycles. Similarly, in the electronics sub-sector, production of TV sets, airconditioners, electric transformers showed significant increase. Domestic demand has picked up, supported by increased exports.

Growth in the Production of Selected Large-scale Manufacturing Items

(%)

Sub-sectors	Weights	July-March FY02	July-March FY03
Textile	19.069	4.3	5.2
Cotton yarn	8.850	4.5	8.1
Food, bev. & tobacco	17.336	5.4	7.2
Sugar	8.630	6.4	12.3
Petroleum products	7.824	17.9	2.2
Fertilizer	5.871	(-)0.6	2.4
Pharmaceuticals	5.284	1.2	0.4
Metals	3.194	(-)5.7	9.1
Billets	0.311	(-)8.5	14.0
HR coils & plates	0.074	(-)9.6	29.2
Leather products	2.333	(-)3.2	(-)6.6
Chemicals	2.335	(-)2.3	17.5
Electronics	2.230	31.8	19.3
Electric transformers	0.577	45.2	34.3
TV sets	0.363	(-)27.3	59.1
Airconditioners	0.120	(-)71.5	69.1
Refrigerators	0.015	10.3	23.1
Automobiles	2.348	(-)5.7	46.9
Trucks	0.698	(-)8.0	118.1
LCVs	0.369	9.1	57.6
Car & Jeeps	0.309	0.9	51.6
Buses	0.130	(-)30.3	42.3
Non-metallic minerals	1.915	(-)2.7	20.0
Paper & board	1.359	(-)38.2	15.7
Engineering	0 712	(-)2.3	12.4

Main Drivers

Source: - The State of Pakistan's Economy, Third Quarterly Report for 2002-03 State Bank of Pakistan

Textile led export growth

A 21% increase in exports in 2002-03 over a year earlier, raised total exports to $11.03 billion, surpassing the year's target of $10.4 billion.

The textile sector remained the major performer, contributing 65% of the overall exports, while the remainder was shared by other items. The other major items that have contributed to the growth rate are, rice (21.8%), wheat (80.9%), other leather manufactures (816.6%), plastic materials (272.8%), chemicals and pharmaceuticals (73.2%). Export of cotton yarn is stagnant at 0.05%, while leather tanned and leather manufactures, surgical and medical instruments registered declines.

Major Exports

($ Mn)

	2002-03	2001-02
Rice	546.1	448.2
Wheat	129.1	71.4
Raw cotton	48.7	24.7
Cotton yarn	930.1	929.7
Cotton cloth	1330.9	1130.8
Knitwear	1136.2	845.9
Bedwear	1320.8	918.6
Readymade garments	1094.5	874.9
Synthetic textiles	561.7	410.0
Sports goods	315.7	304.5
Leather & leather manufactures	581.1	623.1
Chemicals & pharmaceutical products	255.1	152.8
Carpets & rugs	208.6	249.6
Surgical & medical instruments	138.6	145.0

Source: - Federal Bureau of Statistics

Unit values realized were higher for some items. Inspite of a drop in the quantum of readymade garments exported, earnings had risen, while for items like rice, cotton cloth, bedwear the increase in value was more than the rise in quantum exported.

Higher growth in exports were due among others, to increased textile quota and market access in the European Union, reduction in the refinance rate under Export Finance Scheme and value addition in textile manufactures. Exports remain concentrated in a few items and are a major source of instability in export earnings.

Imports exceed target

Imports during FY03 estimated at $12.1 billion surpassed the target of $11.1 billion set for the year and are higher by 17.5% over last year's imports of $10.3 billion. This increase is attributable to higher imports of petroleum, various kinds of machinery, palm oil, soyabean oil, chemicals among others.

Major Imports ($ Mn)

	2002-03	2001-02
Wheat	28.7	50.0
Tea	172.5	156.5
Soyabean oil	47.7	12.7
Palm oil	532.6	380.3
Sugar	2.5	23.4
Pulses	115.0	135.9
Power generating machinery	262.8	203.8
Textile machinery	524.8	406.9
Electrical machinery	211.6	128.0
Road motor vehicles	492.4	329.9
Petroleum & products	3060.9	2807.0
Plastic materials	422.9	352.7
Iron & steel	400.0	336.0
Fertilizer	239.7	176.2
Medicinal products	218 0	228 0

Source: - Federal Bureau of Statistics

During July-June 2002-03, petroleum imports grew by 9% over the year to $3.1 billion or 25% of total imports. Increase in unit price of petroleum products, led to the rise in oil imports.

Machinery imports which constitute 23.3% of the total imports, showed a 28.6% increase during 2002-03 over a year earlier. In the machinery category, textile machinery had the highest share (4.3%) in overall imports, followed by road motor vehicles (4.0%), the later largely because of higher imports of cars and buses & their spare parts owing to rising demand. Electrical machinery showed a growth of 65.2%.

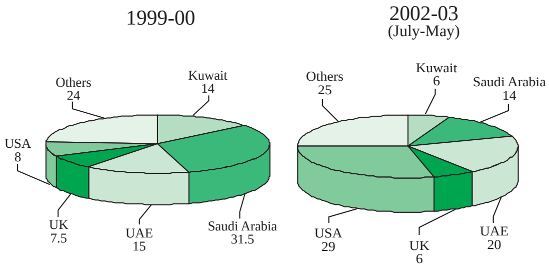
In the food group, import of soyabean oil showed a substantial growth of 276.9% because of jump in quantum of imports. Palm oil imports have risen by 40.0%, while import of pulses, sugar and wheat declined by 15.4%, 89.1% and 42.5% respectively.

Remittances target surpassed

Workers' remittances showed a substantial jump of 82.7% in FY03 (July-May), rising to $3873.4 million against $2120.5 million in the corresponding period a year earlier. These are projected to cross $4 billion mark by end FY03.

The composition of the origin of remittances has changed significantly in the last few years. During 2002-03 (July-May) remittances from the US had risen to $1130.6 million, against only $80 million in FY00, while from the UAE it rose to $770.1 million from $148 million, from Saudi Arabia to $527.4 million against $310 million. The increase is attributable to greater scrutiny of assets abroad and shift in transfers from hundi to official banking channels, increasing restriction on undocumented transaction, thereby reducing Dubai's role as a hub of hundi activity.

Origin of Remittances
(%)



Buildup in foreign exchange reserves

Foreign exchange reserves continued to build up and rose to $10.7 billion by end June 2003, having added $3.6 billion since July 2002. This impressive buildup in reserves, is sufficient to finance 11 months of imports. The rise in reserves is attributable to large inflows of workers' remittances, enhanced foreign direct investment inflows and loans from IFIs.

Interest rate environment

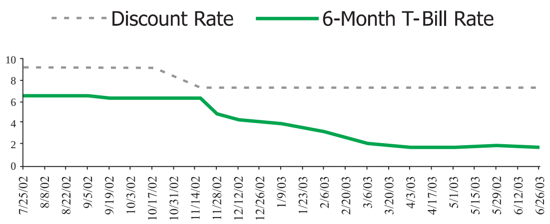
The State Bank of Pakistan (SBP) continues with an easy monetary policy. This change in SBP stance occurred at the beginning of 2001-02 and has continued since. The discount rate gradually lowered to 7.5%, in November 2002 remains unchanged. Yield on treasury bills have fallen in each successive auction to less than 2% by end March 2003. As the return on various national saving schemes have been slashed, the government has benefited as it has reduced its cost of non-bank borrowing.

The weighted average lending rates of commercial banks declined from 12.17% in July 2002 to 8.26% in March 2003, with foreign banks taking the lead. They were quick to respond to the changing banking environment reflecting better management practices.

Following the decline in lending rates, weighted average deposit rates also witnessed a fall of 121 basis points during July-March FY03.

On a cumulative basis, the banking spread saw a squeeze of 270 basis points during the same period. Export refinance rate has also come down to 3.5% from 8.0% in July 2002.

Interest Rate
(%)



Prices remain subdued

In FY03, inflation remained subdued as both Consumer Price Index (CPI) and Sensitive Price Indicator (SPI) were well within targets. The CPI registered an increase of 3.2%, during July 02-May 03, despite a 16.4% monetary expansion upto June 14, 2003. This is attributable to better food supplies and appreciating rupee-dollar parity. The non-food component of CPI registered a slightly higher increase because of the rise in the price of POL products.

WPI inflation was much higher at 6.1%, primarily because of a rise in the prices of some raw materials and building materials and a larger impact of energy prices on this index compared to the CPI. The non-food WPI was much higher at 8.5% than non-food CPI.

Public debt brought down

The rising stock of public debt has been arrested in FY03, by Rs.52.3 billion, as it fell to Rs.3642.5 billion from Rs.3694.8 billion a year earlier. In terms of GDP it has been reduced from 101.8% to 90.7% and as a proportion of total revenue from 592% to 516%. While there was a rise in the volume of domestic debt in 2003, as percentage of GDP it declined from 47.2% to 43.5%. The rising trend in external debt has been brought down from Rs. 1983.5 billion in 2002 to Rs. 1898.2 billion last year, or from 54.7% to 47.2% in terms of GDP.

Reduced fiscal deficit, surplus current account balance, reduction in cost of borrowing, financing support on concessional terms from IFIs, and Paris Club rescheduling provided substantial relief to the country and has opened the pathway to achieve debt sustainability.

GoP addresses poverty

Amid positive economic developments is the growing concern for rising poverty in Pakistan. The poor have not only low incomes but they also lack access to basic needs such as education, health, clean drinking water and proper sanitation.

The government recognizes this problem and has adopted a poverty reduction strategy to meet the challenges of reviving broad based equitable growth and reducing poverty.

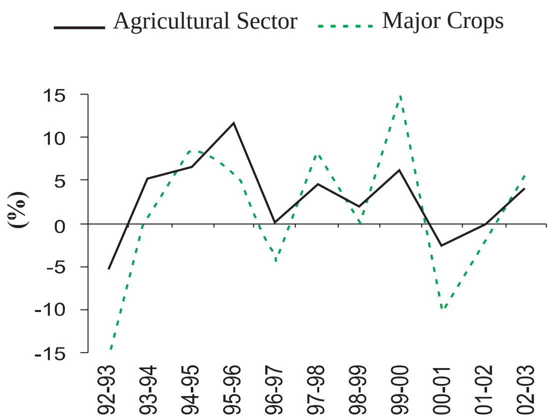
The current budget will be spending larger sums on poverty reduction, including health, population planning, water supply, sanitation and housing. With the present improvement in economic indicators and given the continuity and strengthening of economic policies one hopes to see a much more broader based development in the current fiscal year.

Agriculture

Recovery in agricultural growth

Pakistan's agricultural sector staged a recovery in FY03 by posting an estimated 4.1% growth, following two years of decline averaging 1.4%. The higher growth during the year compares favourably with the 2.5% target and the annual average of 2.8% growth during the past 10 years. This is attributable to a combination of factors; increased use of improved seeds, higher fertilizer offtake, extensive plant protection measures adopted, easy availability of credit under one window operation, and the relatively better availability of irrigation water has had a positive impact on overall agricultural production.

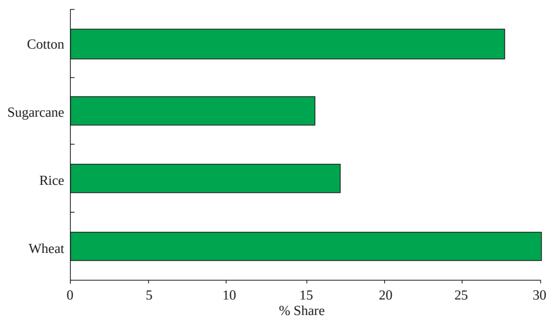
Growth Trends



Water availability improves

The sector has been experiencing severe drought since the past three years. Though water shortages persisted in FY03, the intensity has subsided as the canal head withdrawal during Kharif and Rabi improved significantly. Heavy snowfalls on mountains during winter and above normal winter rainfalls improved water supplies over last year.

Share in Value Added of Major Agricultural Crops



Major crops performed well

Major crops had declined by 9.8% in FY01 and by a further 1.8% during FY02. The growth in FY03 was targeted to be almost flat at 0.4%. However, its production during the year registered a sharp recovery and grew by 5.8%. Major crops account for 41% of agricultural value added with wheat, rice, sugarcane and cotton contributing over 90% in the value added of major agricultural crops. Among these four crops, rice, wheat and sugarcane have reportedly performed well during the year. Their contribution to value added in overall agriculture was 37%.

Minor crops grew by 0.4% in FY03 following two years of decline. Their contribution in agricultural value added is 16%.

Wheat

Area / production below target

The growers have reportedly harvested 19.2 million tonnes from the 2002-03 crop, 6.8% short of the revised target of 20.63 million tonnes, but 5.5% higher than the 18.2 million tonnes harvested last season. The sown area dropped by 0.1 million hectares against the target of 8.08 million hectares. The government had initially fixed a production target of 19.75 million tonnes, which was later revised upward to 20.63 million tonnes after heavy rains in mid-February improved water availability. However, high temperature at grain formation stage and aphid and rust attack in major wheat growing areas affected the crop.

Slow procurement

Procurement drive has slowed apprehending a lower crop. So far 3.5 million tonnes of wheat or 66% of the target of 5.3 million tonnes have been procured. The Punjab Food Department has reportedly procured 2.4 million tonnes, while the Sindh Food Department has failed to achieve even 50% of the provincial target of 0.5 million tonnes. Beside fear of lower crop, increase in wheat prices in the local market above the official procurement price of Rs.300 per 40 kgs is also contributing to slower procurement.

Low production to affect exports

An anticipated shortfall in production and slower procurement drive have forced the government to temporarily halt its wheat export programme. Pakistan commenced exporting wheat for the first time in 2001, and found a sizeable market in Middle East, Africa, and in some European and Southeast Asian countries. About 0.7 million tonnes of wheat was exported last year but this year due to lower crop prospects, the country may have to import about 0.5 million tonnes.

Higher target for 2002-03 crop

The government has tentatively fixed the production target at 20.5 million tonnes for the 2003-04 crop, 6.8% higher than the current estimates for 2002-03 crop when growers harvested 19.2 million tonnes.

Rice

Sowing of new crop begins

The government has fixed a production target of 4.55 million tonnes for the 2003-04 crop, higher by 1.6% over previous season's bumper harvest. In Punjab farmers are engaged in preparing nurseries for basmati rice, while this operation for coarse rice has almost completed. The farmers in Sindh are busy transplanting Irri variety of rice. Last season, rice growers reaped a bumper crop from the 2002-03 harvest, provisionally estimated at 4.48 million tonnes, which not only surpassed the target by 12% but was 15.5% above the previous crop of 3.88 million tonnes.

Basmati sown in Sindh

The 2003-04 crop will be sown over an area of 1.54 million hectares in Punjab — 1.34 million hectares under basmati and 0.20 million hectares under Irri-6. Sindh is known for the production of Irri-6 and Irri-9 varieties of rice, but due to shortage of irrigation water, the province has started growing basmati and for the first time harvested 300 thousand tonnes of basmati variety in 2002-03. Measures have been taken by the farmers in the province for the cultivation of super kernel, a high quality rice variety which is in high demand in Middle East. Some 0.550 million tonnes of basmati variety is expected to be produced.

Basmati exports pickup

Meanwhile, Rice Export Association of Pakistan is exploring rice market in Iran for both basmati and irri-9. Upto May, about 1.65 million tonnes of rice was exported, 9% higher over 1.51 million tonnes exported in the comparable period of previous year. During this period, export of basmati increased by 32.6%, while that of irri variety declined by 2.2%.

Rice prices firm

Since the middle of June there has been a firming up of price in the local market, as stocks have depleted. The market activity is expected to be sluggish until the arrival of the new crop. Fresh supplies from Punjab are expected in late August. Rice prices are expected to remain high in view of low stocks. Prices of Irri-6 and Irri-9 varieties in Karachi wholesale market have risen and were in the range of Rs.965 — Rs.1262.50 per 100 kgs during the last week of June against Rs.950 — Rs.1237.50 per 100 kgs in the last week of April. In the same period, prices of super basmati (old/new) have also risen from Rs.2450/2550 to Rs.2775/2850 per 100 kgs.

Cotton

Produc-tion declines

Growers harvested 10.2 million bales from the 2002-03 crop, achieving 97% of the target of 10.5 million bales. It however, represented a decline of 3.8% over the 10.6 million bales produced a year earlier. Pest attack and shortage of irrigation water during the Kharif season caused area under the crop to decline to 2.8 million hectares or by 10.3% over preceding year's sown area. It also fell short of the sowing target for the year by 5.4%. The decline in production would have been higher, had per hectare yield not increased by 7.2% to 621 kgs due to efficient use of high quality seeds and sowing of new cotton varieties.

Higher target for 2003-04

A higher production target of 10.55 million bales has been fixed for the 2003-04 crop. Sowing of the new crop which commenced in February in some areas of Punjab is now almost complete. Initial reports put sown area under cotton at 2.86 million hectares, 4.4% more against the previous season's acreage.

Support price increased

To achieve this season's production target of 10.55 million bales, Sindh is expected to produce 2.4 million bales and Punjab 8 million bales, while NWFP and Balochistan will produce 0.15 million bales. As an incentive to cotton growers to increase production, the Federal Government has increased the support price of seed cotton by Rs.50 per 40 kgs and pegged it to Rs.850 per 40 kgs for the 2003-04 crop.

Ginners/ Exporters holding unsold stocks

The ginners and exporters are holding unsold stocks of 0.1 million bales and 25 thousand bales respectively from the previous crop. Ginners want better price for their stocks, while exporters are looking for foreign buyers. Till May 03, Pakistan had exported 0.32 million bales.

Cotton prices down

In the past two months, KCA spot price for the 2002-03 crop has fallen in the local market from Rs.2530 to Rs.2425 per maund. In the New York future market also, cotton prices have come down from 56 cents to 53 cents per lb in the same period. As a result, ginners are not willing to dispose off their unsold stocks and exporters are reluctant to export. On the other hand, falling prices in the international market have become attractive to spinners who are willing to import more cotton. So far this year, about 0.6 million bales of cotton has reportedly been imported by domestic mills. Domestic mills consumption requirement is projected at 12 million bales.

Sugarcane

Bumper harvest

Growers harvested a bumper crop of 52.05 million tonnes during 2002-03 crop year, surpassing the target for the second consecutive year by 8.2% and an increase of 8.3% over the previous crop of 48.04 million tonnes. Larger area was brought under the 2002-03 crop, sown at over 1.09 million hectares against the target of 0.99 million hectares and preceding season's 1.0 million hectares. The increase in area and production is attributable to judicious application of fertilizers and water, better management practices, higher return to farmers and timely payment received by the growers last year. Production target for this season has been placed at 52.5 million tonnes, marginally above last season's output.

Rising sugar stocks

The sugar industry is faced with large stocks of unsold sugar (due to three consecutive bumper sugarcane crops), high cost of production contrasted by low prices. Import of 0.633 million tonnes of refined sugar in 2000-01 resulted in huge build up of surplus sugar with stocks reaching over 1.0 million tonnes in the current crushing season, when sugar production has reportedly touched 3.7 million tonnes, 15.6% above the previous crushing season.

Sugar export unattrac-tive

Large unsold stocks are worrying sugarmill owners. They would like the government to allow Pakistan Sugar Mills Association to export at least 0.3 million tonnes of sugar. This would enable them to dispose off surplus stocks before the commencement of next crushing season. Since international prices of sugar are currently being quoted below $200 per tonne (fob) making sugar export unattractive, sugarmill owners may find it difficult to get rid of surplus stock.

Sugar prices down

Earlier the government had agreed to export 0.3 million tonnes of sugar through the Trading Corporation of Pakistan (TCP), out of which the Corporation had lifted 0.1 million tonnes from the mills for export purposes. But till mid-May only 12000 tonnes were exported, while export of 23000 tonnes to Afghanistan is in progress. The TCP seems to have abandoned, for the time being the purchase of the remaining 0.2 million tonnes due to export difficulties. At the same time, sugar prices have crashed below cost of production in the local market. Currently the ex-mill rate is Rs.15.50 per kg and wholesale price is Rs.17.50. This situation may adversely affect industry performance during the next crushing season.

Banking and Finance

Key Monetary Indicators (Rs. Bn)

	June 28, 2003	March 29, 2003	June 27, 2002
Scheduled Banks' Deposits	1741.3	1653.4	1468.1
Scheduled Banks' Advances	972.4	918.7	884.8
Scheduled Banks Investment in Securities & Shares	690.6	690.2	470.8
Notes in Circulation	524.9	516.6	460.7
Approved Foreign Exchange (incl. balances held outside Pakistan in approved foreign exchange)	563.2	545.3	287.9

Source: State Bank of Pakistan

Deposits continue to grow

Scheduled banks deposits continued to grow and in the week ended June 28, 2003, these stood at Rs.1741.3 billion, 5.3% higher over the figure recorded three months earlier and 18.6% more than the corresponding figure a year earlier.

Advances increase

Scheduled banks advances to the different sectors of the economy rose to Rs.972.4 billion in the week ended June 28, against Rs.918.7 billion at end March 2003. Current week's figure was higher by 9.9% over last year's corresponding figure.

Invest-ments rise marginally

Scheduled banks investment in central government securities, Treasury bills and other approved securities rose marginally in the current week when compared to three months earlier, but when compared to the corresponding week a year earlier, it was 46.7% higher.

Notes in circulation rises

Notes in circulation rose in the week ended June 28, 2003 to Rs.524.9 billion, higher by 1.6% over the figure recorded three months earlier, and by 14% over the corresponding figure a year earlier.

Approved foreign exchange grows

Approved foreign exchange including balances held outside Pakistan rose to Rs.563.2 billion in the week ended June 28, 2003 or by 3.3% over the figure of Rs.545.3 billion recorded three months earlier. Current figure was nearly double the level of Rs.287.9 billion recorded a year earlier.

Monetary Trends

The Credit Plan for 2003-04 proposes monetary expansion of Rs.230 billion or 11%, contributed by expansion of Net Foreign Assets (Rs.130 billion) and Net Domestic Assets of the banking system (Rs.100 billion). GDP is expected to grow by 5.3% and inflation is targeted at 4.0%.

Last year there was considerable monetary expansion, as per available figures. Between July 2002-June 21, 2003, there was an expansion of 16.4% or Rs.289.3 billion, against a revised monetary expansion target of 16% for the year. Net foreign assets (NFA) of the banking system expanded by 128.1% (Rs.307.6 billion), while net domestic assets (NDA) of the banking system showed a contraction of Rs.11.2 billion. The rise in NFA was because of substantial increase in workers' remittances, foreign direct investment inflows and aid inflows. Against a Rs.50.2 billion expansion estimated in the Credit Plan 2002-03 for the private sector, there was an increase of Rs.138.2 billion. Despite a record high credit off-take by the private sector, NDA declined.

Lower govern-ment sector borrowing

In contrast there was substantial retirement of government sector borrowings from the banking sector. This was on account of both retirement for budgetary support as well as commodity operation loans. The SBP report attributes the former "as simply the result of substantial net foreign assistance and the continuing demand for national saving instruments, which forced the government to retire its T-bill holdings". The retirement of commodity operation loans, "indicates the improved financial position of relevant federal agencies as well as the provincial governments and the success of the government policy of transferring this activity to the private sector".

Monetary Indicators

Targets and Actuals

(Rs. Mn)

Sectors	Revised Credit Plan 2002-03	Stocks		Flow up to
		30-Jun-02	21-Jun-03	21-Jun-03
I. Government Sector Borrowings (Net)	-44200	624047	551048	-72999
(A) Net Budgetary Borrowings	-29200	514201	462066	-52135
(B) For Commodity Operations	-16000	100642	75599	-25044
(C) Others	1000	9204	13384	4180
II. Non-Government Sector (A+B+C)	70200	921597	1047457	125860
(A) Public Sector Enterprises incld. Autonomous bodies	20000	81875	76749	-5126
(B) Private Sector	50200	801844	940009	138164
(C) NBFIs		37877	30699	-7178
III. Other Items (Net)	-15500	-18780	89966	-71186
IV. Net Domestic Assets (I+II+III)	10500 0.69%	1526864	1508539	-18324
V. Net Foreign Assets	271000	234506	542141	307636
VI. Monetary Assets (IV+V) (IV+V)	281500 16.00%	1761369	2050681	289311 16.43%

Source: State Bank of Pakistan

Strict financial discipline during the year 2002-03 helped the government to retire credit. Net retirement of credit for budgetary support from the banking system upto June 21, 03 was Rs. 52.1 billion, higher than the year's target of Rs. 29.2 billion.

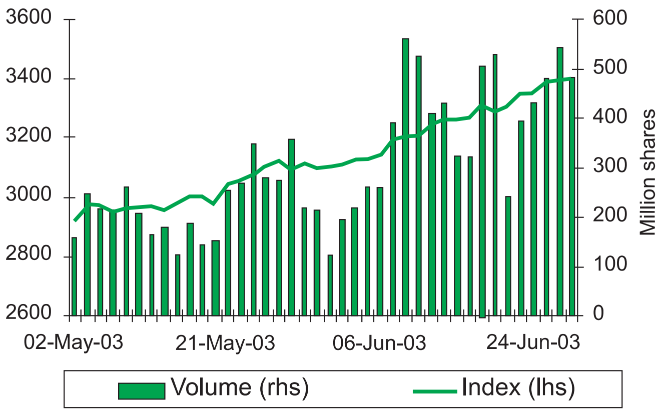
A breakup of net retirement figures shows that borrowings from the banking system, incorporates a Rs. 180.0 billion increase in net borrowings from scheduled banks, which was more than offset by a Rs. 233.8 billion retirement of the government debt with State Bank.

Market Analysis

Market Outlook

May and June 2003 saw the market reach new peaks in what were largely speculative movements. The market surged almost 500 points during the period, most of it in June. Market performance in May was good. The KSE-100 Index rose 7% (197 points) to reach 3099 by the end of the month. There was a run up in the cement sector prior to the budget announcement on expectations of incentives for housing and construction, but badla rates were low and the market was not overextended.

KSE-100

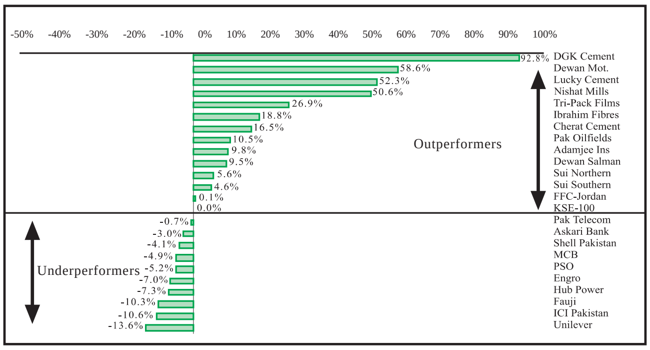


Rally led by second-tiers

June saw the Index rise over 300 points, led by second-tier stocks. The market closed down only 3 days out of 21 trading days that month. By the end of June certain sectors appeared to have reached dangerous levels- in particular the cement sector, select textile stocks (Nishat Mills and Kohinoor Textiles), and Dewan Motors. The KSE-100 Index crossed 3400 points before the month end without the major stocks (PTCL, Hubco, FFC, PSO) showing gains for most of that period.

With the exception of SNGPL and Pakistan Oilfields, blue chips have all under performed the market in the May-June period (see comparative performance chart). In valuation terms, the price-to-earnings multiples for the most active second-tier stocks were well in excess of their historic averages. For blue chips the valuation difference versus historic levels is not that great.

Comparative Performance (May 01, 2003 - Jun 27, 2003)



Budget satisfactory- but no surprises

The budget for FY03-04 was satisfactory in that it continued with earlier reforms, but there was no major incentive or innovation to fuel heavy buying in any sector.

The budget did aim to improve construction activity with its reduction in CED on cement, and the allowance of interest charges on home loans to be deducted from income tax liability. These incentives have improved the sector outlook for cement, but the effect is expected to be gradual. The incentives from the budget were not sufficient to justify the share price valuation of cement companies that has been seen over the last two months. The budget was also positive for the PSF sector because of its extension of the DTRE scheme to local PSF products.

Market looking risky

The fact that blue chip stocks did not participate in the rally is a red flag. Given the high liquidity in the market, the equity market is expected to rise, but on a broad front. Market moves in May and June were heavily and unjustifiably weighted in favor of second-tier stocks. Furthermore, institutional investors did not chase the second-tier rally, so the risk of flight by over leveraged retail investors is high in case of a turn in sentiment.

As of June 27th, 2003, average badla rates had crept up to 16% (18% and over for DG Khan Cement, Lucky Cement, Nishat Mills, and SNGPL; 17% for Dewan Motors, Engro and Hubco; and 14% for PTCL) with over Rs1.3b in badla trading. The high rates are bringing pressure upon the market and there is a danger of the market overextending itself. We do not expect a major correction of the scale seen in January 2003, but a rationalization between the blue chips and second-tier stocks is due.

Conclusion

The valuation gap between blue chips and second-tier stocks needs to close. The market is expected to rationalize- some of the more overvalued second-tier stocks will fall, and blue chips will begin to perform. There were signs that this was beginning to happen towards the end of June (Hubco, PTCL and Engro began to show upward moves). Caution is required given current market conditions- there is a risk that the rationalization will not happen smoothly, and market turmoil could affect blue-chip valuations as well in the short term. Investors should reduce exposure to the market and focus on blue chips.

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

Key Economic Indicators

Economy Size & Growth			1999-00	2000-01	2001-02	2002-03
GNP - Market Prices		Rs bn	3102.3	3372.4	3660.7	4198.7
GDP - Market Prices		Rs bn	3147.2	3423.1	3628.7	4018.1
Per Capita Income	Market Prices Rs		22811	24248	25767	28933
	Market Prices US $		441	415	419	492
Growth						
GDP		%	3.91	2.22	3.36	5.8
Agriculture		%	6.09	-2.74	-0.07	4.15
Manufacturing		%	1.53	8.21	5.00	7.67
Wholesale & Retail trade		%	1.92	5.37	2.28	7.32
Rate of Inflation		%				
Consumer Price Index			3.6	4.4	3.5	3.1
GDP Deflator			2.8	6.0	3.2	4.5
Balance of Payments		$ mn				
Exports (f.o.b.)			8190	8933	9140	9739*
Imports (f.o.b.)			9602	10202	9434	10149*
Trade Balance			-1412	-1269	-294	-410*
Services Account (Net)			-2794	-3142	-2617	-1726*
Private Transfers (Net)			3063	3898	4249	5080*
Current Account Balance			-1143	-513	1338	4858*
Fiscal Balance		% of GDP				
Total Revenue (Net)			16.3	16.2	17.2	17.6
Total Expenditure			22.5	21.0	22.8	22.2
Overall Deficit			6.2	4.8	5.6	4.6
Domestic & Foreign Debt						
Domestic Debt		Rs bn	1641.4	1799.2	1757.6	1770.6
As % GDP			52.2	52.6	48.4	44.1
Total External Debt		$ bn	32.3	32.1	33.4	33.5
Total Debt Servicing+		$ mn	1512	1961	1200	1416
As % GDP			2.5	3.3	2.0	2.1
Investment & Savings		% of GNP				
Gross Investment			16.0	15.5	14.7	15.5
Fixed Investment			14.4	13.9	13.1	13.1
National Savings			14.1	14.6	17.0	19.2
Domestic Savings			15.6	16.1	16.1	14.7
Foreign Investment		$ mn	543.4	182.0	474.6	742.8*
Portfolio			73.5	-140.4	-10.0	-1.9*
Direct			469.9	322.4	484.7	744.7*
Monetary Aggregates		%				
M1			14.9	3.0	15.2	19.0
M2			9.4	9.0	15.4	12.5
Interest Rates (Weighted Average)		%				
Deposits			5.89	5.00	4.73	2.41*
Advances			14.02	13.74	13.12	7.09*
Foreign Exchange Reserves**		$ mn	2163	3244	6399	10601
Exchange Rate++		Rs./$				
Official Rate			52.16	64.40	60.05	57.84
Open Market Rate			54.82	66.70	60.20	57.80

Source: Economic Survey 2002-03

* July-May
\+ Excludes interest on short term borrowings, IMF charges and Euro Bonds.
++ End-June Buying Rate
** Excludes FE 13/CRR and includes Indian pending transfers, new FCA and Trade Nostro.