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NBP Performance at a Glance

## Editor's Corner

Dear Readers,

The State Bank of Pakistan (SBP) raised its discount rate by 50 basis points to 14 percent, w.e.f. November 30, 2010. This was the Central Bank's third consecutive hike since the beginning of FY11 (in July and September 2010, the rate was raised by 50 bps each). The rationale for the rate hike has been the persistently high inflation and fiscal slippages leading to unabated government borrowing. Through adjustment in the policy rate, the Bank seeks to contain the double digit inflation, while supporting economic growth.

The Monetary Policy (November 2010) identifies the following factors which constrain the economy's ability to achieve sustainable recovery and growth: -

- the slow progress in the prevailing security and economic conditions.
- high and persistent inflation.
- continuing fiscal slippages.
- unresolved power sector issues.
- high level of government borrowing from SBP.

Pakistan faces severe fiscal challenges. The tax base continues to remain narrow, while rising security and flood related expenditures and continued power subsidies has resulted in a declining tax-GDP ratio (declined to 9 percent in FY09).

For 2009-10, subsidies to WAPDA and KESC were budgeted at Rs62.9 billion and Rs3.8 billion; while revised estimates show a substantial enhancement in subsidies to Rs147 billion and Rs32.5 billion respectively. Expenses on defence, war on terror and power tariff subsidy have raised total expenditures.

While expenditures rose in FY10, taxes fell short of the target and total revenues could not meet the projections for the year. Rising fiscal pressures and slower flow of external finance resulted in a breach of IMF ceiling on the budget deficit and net government borrowings from the SBP. About 60 percent of the financing requirements were met through non-bank sources, the government had to resort to borrowings from the central bank as well, which has negative implications for inflation.

Reduced borrowings from the State Bank is essential for achieving a durable reduction in inflation. During the current fiscal year, reserve money expanded by Rs308 billion (uptil November 19, 2010) of which Rs266 billion was due to government borrowings from the SBP, which has been on an increasing trend since January 2010.

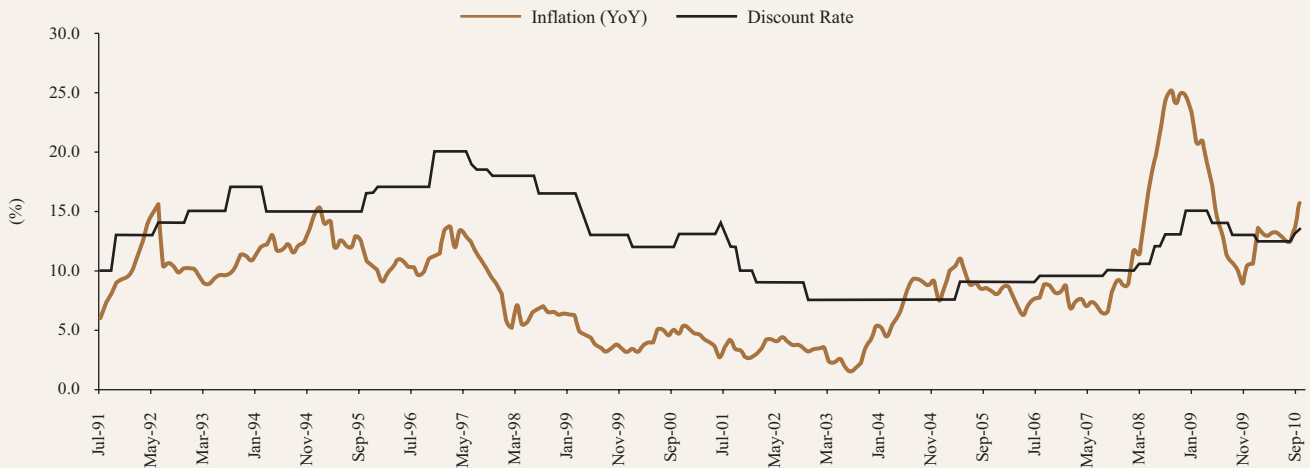
Apart from causing inflation, unrestricted access of the government to borrowing from SBP complicates liquidity management, dilutes the impact of the monetary policy stance, puts pressure on the exchange rate and hurts the private sector by affecting availability and cost of credit, said the Governor SBP recently.

Some reforms have been undertaken by the government to reduce government borrowings from banks. Ministry of Finance has piloted an amended SBP Act through the National Assembly. It limits government borrowing from SBP and is also bound to gradually reduce its current stock of borrowing from SBP (Rs1355 billion or 65 percent of revenue) in next 5 years.

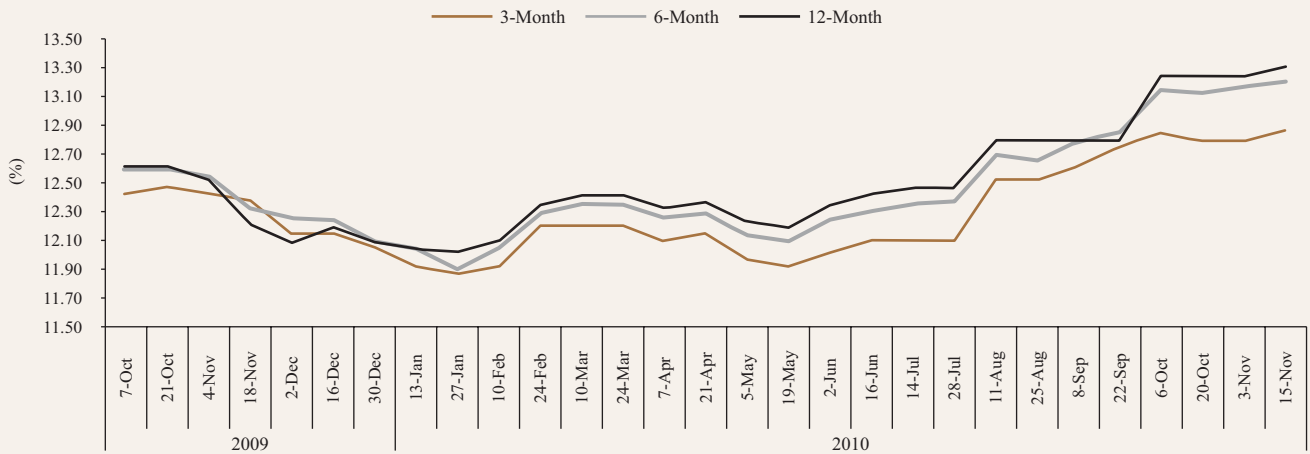
This together with introduction of Reformed General Sales Tax (RGST) and other tax measures, could address the high inflation expectations, reduce the cost of borrowing and pave the way for long term economic growth.

*Ayesha Mahmood*

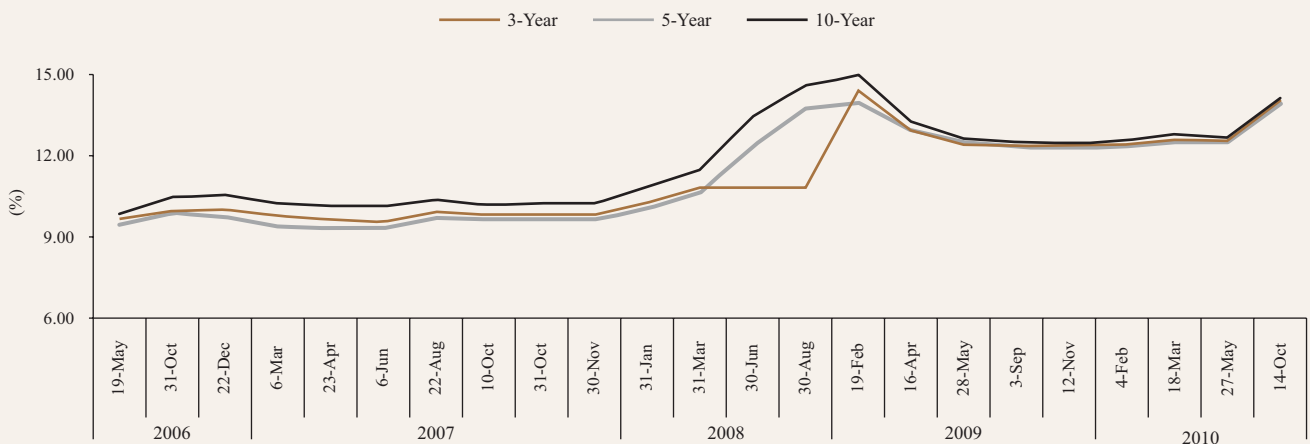
Policy Rate vs. Inflation in Pakistan



Treasury Bills – Cut-off Yield



Pakistan Investment Bonds – Cut-off Yield



## Pakistan in the Aftermath of the Floods

Rains cause wide-spread damages

The 2010 monsoon rains caused the worst floods in Pakistan's history, affecting one-fifth of the country and leaving millions homeless. Nearly 84 districts out of a total of 121 districts in Pakistan and more than 20 million people — one-tenth of the country's population were affected. Floods caused significant damages to life, livestock and property. More than 1800 people lost their lives, and at least 1.8 million homes were damaged or destroyed.

The agricultural sector was impacted, with losses to standing crops, (on more than 2 million hectares), livestock, household storages, personal seed stocks and agricultural implements. A large number of water wells were clogged with mud and silt. Essential infrastructure, including roads, bridges, phone lines, electricity supply and installations were significantly damaged. According to estimates, by the Asian Development Bank and the World Bank, the floods caused \$9.7 billion in damage to infrastructure, farms, homes, as well as other direct and indirect losses.

The economic impact of the massive flooding is quite extensive. While precise estimates are not yet available, preliminary estimate show that economic costs would be significant and would have implications for growth prospects, public finances, balance of payments and poverty.

Agri losses

As there has been a considerable loss of agricultural crops, and livestock, agricultural output would be affected. A *World Food Programme Report, 'Pakistan Floods Impact, Assessment', September 2010*, states, 'between 60 and 88 percent of the farming households reported losses of more than 50 percent of their major crops: rice, vegetables, cotton, sugar and fodder. These households were mostly located in Punjab and Sindh. Because of the losses there are risks that the agricultural growth could turn negative, unless there is a good wheat harvest.

The recent floods have not only damaged the standing kharif crops, but some areas may not

even be available for cultivation of the Rabi crops, because of the silt.

Agriculture has been the most severely affected sector. Overall damages to the agricultural sector amount to Rs429 billion. As crops were ready for harvest, almost all of the damages caused in the sector can be considered as loss. This implies that the value added in crop agriculture, which was targeted to increase by 3.5 percent in 2010-11, is now projected to decline by about 10 percent, with major crops showing a decline of about 7 percent and minor crops of 20 percent.

Floods have added to the strains. Some 2.1 million hectares of standing kharif crops were reported damaged. It resulted in a loss of 7.5 million tonnes of sugarcane, 2.5 million tonnes of rice, 0.8 million tonnes of vegetables, 0.7 million tonnes of cotton and 0.3 million tonnes of maize. Highest losses in terms of area cultivated were recorded in Sindh, followed by Punjab, Balochistan and Khyber-Pakhtunkhwa (KP).

Livestock suffers

Livestock has suffered losses and its growth in FY11 is anticipated to be much lower than the 4.1 percent growth in FY10. On average households lost almost 40 percent of their livestock in the flood affected areas. Some managed to bring some or all of the livestock from the flood waters, while others were forced to sell their cattle. Poultry suffered huge losses with households reporting that more than 70 percent of their birds drowned. FAO estimates that 1.2 million heads of livestock were lost, not including the 6 million poultry lost.

Livestock has an important role in the economy, contributing about 52 percent of agricultural value added and around 11 percent to GDP. It serves as a vehicle to alleviate poverty, widespread amongst the rural population, where livestock is bred. Government gives high priority to its development and is focused on private sector led development of livestock.

Direct and indirect losses in the livestock sector are estimated to be Rs48 billion. These are the findings of the joint Asian Development Bank and World Bank, *Preliminary Damage and Needs Assessment Report of the Floods in Pakistan*. Large numbers of livestock were killed during the floods. Among those that survived, a large number were sold, often at low prices for farmers found it difficult to feed them.

This sector has strong linkages with economic growth, and any damages caused to the sector implies loss of employment, growing poverty, loss of raw material for industries like leather and other industries and loss of foreign exchange earning.

Literature shows that following the floods in Bangladesh, seeds and planting material – particularly vegetable seeds and tree seedlings were provided to small holders as part of a broad livelihoods approach. These could be used by small holders and even landless households to till their land. Replenishing small stock, such as chickens, ducks and goats that could be raised with limited land, was also important particularly for the poor. There are grave implications from the loss of livestock animals like buffalo and cow.

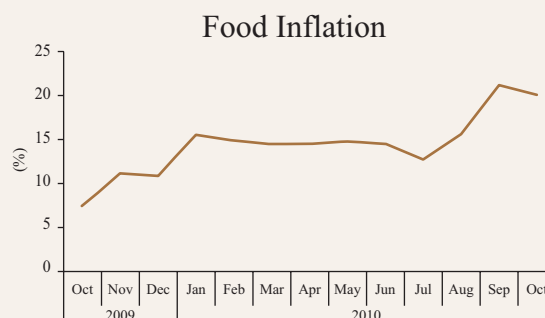
And along with animal losses across the provinces not only will the growth of livestock sub-sector be affected, but large numbers whose livelihood depends on the sector will suffer.

With loss of crops especially cotton, rice and sugarcane and livestock, production losses in agricultural sector seem quite certain. With damages to agricultural and other sectors of the economy, it would have an adverse impact on economic growth. GDP growth is unlikely to exceed 2.75 percent in 2010-11 states the *IMF Country Report September 2010 on Pakistan*. *State Bank Annual Report 2009-10* projects GDP growth in FY11 between 2.0–3.0 percent, lower against the Annual Plan target of 4.5 percent.

Inflationary expectations have now been strengthened because of the impact of the

Inflationary expectations

floods in Pakistan. Agricultural damage has already started to push up prices, especially of food items. In September 2010 the month-on-month CPI inflation surged by 2.7 percent, the highest increase in a year. Food inflation was much higher, rising by 5.3 percent, against 1.1 percent a year earlier. Moreover, year-on-year CPI food inflation rose by 21.2 percent in September 2010, against a growth of 10.0 percent in September 2009.



Prices of basic food items like wheat flour, rice, pulses, sugar have risen in recent weeks. Prices of some of the food items were on a rising trend despite substantially higher production than domestic consumption. These include onion, pulses, meat, fresh fruits. This is attributable to strong external demand.

Rising sugar prices in the domestic market was because of higher cost of production, slow pace of imports, hoarding, which raised concerns over adequate availability.

### Domestic Commodity Prices (Rs)

Items	Unit	26-Nov-09	25-Nov-10
Wheat Flour	kg	28.9	30.7
Rice Basmati (broken)	kg	42.4	49.4
Mash Pulse	kg	124.1	164.4
Gram Pulse	kg	50.4	71.9
Mutton	kg	301.9	409.2
Sugar	kg	52.5	79.0
Milk Fresh	1 Ltr	41.4	49.2
Vegetable Ghee	2.5 kg	353.0	413.0
Cooking Oil	2.5 kg	353.0	413.0
Kerosene	1 Ltr	68.6	82.6
Petrol	1 Ltr	62.5	73.7
Diesel	1 Ltr	65.4	79.1

Source: Federal Bureau of Statistics, GoP

Lower GDP growth

***Pakistan Floods – 2010***

Box

***Preliminary Damage and Needs Assessment  
Asian Development Bank & World Bank, November, 2010***

Given below are excerpts from the above mentioned Report:-

- Pakistan experienced extraordinary rainfall in mid-July 2010, which continued until September 2010. The result was unprecedented floods affecting the entire length of the country. The floods have been assessed to be the worst since 1929.
- The overall recovery and reconstruction cost associated with the floods is estimated at approximately \$8.74 billion to \$10.85 billion, which includes estimated costs for relief, early recovery, and medium-to long-term reconstruction.
- This report focuses on an assessment of damage and medium to long-term reconstruction costs.
- The direct damage caused by the floods is estimated at Rs552 billion (\$6.5 billion) while indirect losses amount to Rs303 billion (\$3.6 billion).
- The agriculture, livestock and fisheries sector suffered the highest damages, calculated at Rs429 billion (\$5.0 billion).
- Recovery/Reconstruction Needs – Rs21.8 billion to 89 billion (\$257 million to 1.04 billion).
- As all of the crops affected by floods were ready for harvest, almost all of these damages can be taken as loss in sub-sectoral value added. This implies that the value added in crop agriculture, which was targeted to increase by 3.5 percent in 2010-11, is now projected to decline by about 10 percent (from the level of 2009-10), with major crops showing a decline of about 7 percent and minor crops of 20 percent.
- On the other hand, rupee value of damage to the housing sector is less than one-third of that in agriculture, yet comprises almost 39 percent of the sectoral value-added. With 44 percent of total (direct and indirect) damages, Sindh was the worst affected by floods, followed by Punjab (26 percent) and Khyber-Pakhtunkhwa (12 percent).
- With damages to the extent mentioned above, it is inconceivable that the floods would not have a substantial impact on the economy. Economic growth is likely to suffer a significant deceleration; the impact on prices is already evident with monthly inflation registering the highest increase in over two years; public finances would also be affected due to large-scale increase in flood-related expenditures; and balance of payment is likely to come under pressure as exports would slow down and imports accelerate.
- Before the floods, real GDP was projected to grow by 4.5 percent in 2010-11, but these projections are likely to be revised downward.
- Inflation is likely to remain high.
- Heavy government borrowing from the banking system to meet its burgeoning expenditure is likely to exacerbate the problem.
- Government's fiscal position is likely to get weaker as large proportion of relief, rehabilitation and reconstruction cost would be borne by the government.
- The 2010-11 government's budget targeted a fiscal deficit of 4 percent of GDP, and although this target will require substantial revenue mobilization and a surplus at the provincial level, the government seeks to meet this goal, before the impact of the floods. However, tax revenue may decline as economic activity weakens, while expenditures would increase sharply due to relief, recovery and reconstruction-related efforts.
- Even before the floods, the current account deficit was projected to widen slightly in 2010-11 from the 2 percent of GDP registered in 2009-10. The disaster is expected accentuate this trend, mainly by increasing the trade deficit.
- *Housing* Damage – \$1,588 billion. The floods caused total or partial damage to more than 1.6 million housing units across the country.
- *Health* Damage – Rs4,222 million (\$49.67 million). The floods resulted in mild to moderate damage to the country's public health infrastructure, including basic health units and dispensaries, which suffered the most damage. However, most of the secondary healthcare facilities were unaffected.
- Recovery/Reconstruction Needs – Rs4,151.5 million (\$48.84 million)
- *Education* Damage – Rs26,464.3 million (\$311.3 million). The two worst affected provinces (in terms of numbers) are Sindh and Punjab.
- Recovery/Reconstruction Needs – Rs42,906.58 million (\$504.8 million).
- *Irrigation and Flood Protection* Damage – Rs23,600 million (\$277.6 million). The most extensive damage occurred in Sindh province followed by Khyber-Pakhtunkhwa.
- Recovery/Reconstruction Needs – Rs83,499 million (\$982.35 million).
- *Transport and Communications* Damage – Rs112,911 million (\$1.3 billion). Preliminary estimates indicate that 10 percent of the road network and 16 percent of the railways were damaged by the floods. Damage to telecommunication infrastructure \$35.0 million.
- Recovery Needs – Rs196,466 million (\$2.31 billion).
- *Water Supply and Sanitation* Damage – upto Rs3,195 million (\$38 million).

- Recovery Needs – Upto Rs7,982 million (\$94 million).
- *Energy* Damage – Rs26.3 billion (\$309 million). This comprises direct damage of Rs13.2 billion (\$155 million) and indirect damage of Rs13.2 billion (\$154 million).
- Damage was split fairly evenly between the power sector (total damage Rs13.1 billion / \$155 million) and the petroleum sector (total damage Rs13.2 billion / \$155 million).
- Reconstruction Needs – Rs9.03 billion (\$106.3 million).
- *Private Sector & Industries* Damage – Rs23,932 million (\$282 million). While the major industrial hubs of the country have largely been spared, the floods have seriously damaged micro, small and medium enterprises in manufacturing, trade and services sectors in the affected districts.
- The largest share of damage was to shops, followed by industry, and Sindh province was the worst affected. In Sindh and Punjab, cotton ginning, sugar, rice processing and flour mills are the main sectors damage by floods, while in Khyber-Pakhtunkhwa they are marble, furniture, silk, horticulture, mining and tourism.
- Recovery/Reconstruction Needs – Rs8.6 billion – Rs10.9 billion (\$102 to 129 million).
- *Financial Sector* Damage – Rs57,251 million (\$673.5 million). The impact of the floods on the financial sector has been assessed primarily through the impact on the banking sector, the microfinance sector, and the Non-Bank Financial Institutions sector with particular focus on the insurance industry.
- The estimated physical damage amounts to Rs110 million (\$1.8 million) of which Rs76 million is in the commercial banking sector while Rs34 million is to microfinance institutions (MFIs). Loan losses are over Rs83 billion (about \$1.0 billion); the banking sector constitutes 93 percent of the total (about Rs79 billion) while the remainder is in MFIs and the insurance and leasing sectors.
- Recovery/Reconstruction Needs – Rs39 billion (\$463 million).
- *Governance* Damage – Rs5.9 billion (\$70.3 million). The direct damage to governance institutions has been considerable, with nearly 1,437 critical public service buildings and facilities affected. Local government infrastructure and post offices have been hit the hardest.
- Recovery/Reconstruction Needs – Rs4.9 billion (\$57.65 million).
- *Environment* Damage – Rs992 million (\$11.67 million).
- Recovery/Reconstruction Needs – Rs17.7 billion (\$209 million).
- *Key Lessons Learnt from Flood Response.* Lesson learnt include: (a) The exceptional intensity and prolonged period of the rains and consequent flooding clearly overwhelmed national, provincial and local disaster/flood management capacities, particularly at the district level; (b) the partial implementation of already prepared national response and contingency plans, limitations of existing early warning arrangements down to community level effects disaster preparedness, emergency response mechanisms and structural mitigation; and (c) the affected communities lacked disaster preparedness awareness, sensitization and education regarding localized hazard and flood risk reduction, emergency preparedness and response functions - particularly required for populations located within flood plans.
- Climate change is being considered as a critical factor behind changing rainfall patterns and the visible increase in precipitation during monsoon seasons in parts of the country. As a result, areas along the western rivers of the country (Indus and Kabul) will be more vulnerable to flood episodes similar to the one experienced during the current season.
- The total damage to the irrigation, drainage and flood protection infrastructure has been estimated at Rs23,600 million (\$277.6 million). Infrastructure in Sindh sustained the greatest damage Rs11.6 billion (\$136.91 million), followed by Khyber-Pakhtunkhwa estimated at Rs5.8 billion (\$68 million). Overall, 44 percent of the damage was incurred by canal systems, 36 percent by flood embankments, 10 percent by barrages and headworks, 7 percent by drainage systems and 3 percent by other infrastructure.
- The experience of implementing the reconstruction programme following the devastating 2005 earthquake, and the experiences of recent large scale post disaster reconstruction programmes in other countries offers several relevant lessons. A core set of guiding principles has emerged from these experiences which should be considered for the post-2010 flood reconstruction programme. The following principles are the most relevant:
  - Coordinate centrally, implement locally;
  - Focus on poverty reduction and sustainable livelihoods;
  - Support Government Institutions;
  - Match greater flexibility and speed in Public Financial Management and Accountability
  - Channel funds into the hands of those with the strongest incentives to use them for the intended purposes;
  - Communicate, consult and manage expectations;
  - Maximize credibility through an independent oversight board, third party monitoring and grievance redressal mechanism;
  - Institutionalize urgency in Government and donor institutions.

Food security

Given the loss of standing food crops, food grains stock and livestock, people's livelihood and food security situation has become of particular concern. An increasing number of people are vulnerable to food insecurity and it is an increasing issue in Pakistan. Over 48 percent of Pakistanis are food insecure, according to Swiss sponsored report, the *State of Food Security in Pakistan*.

Prices of wheat have risen, and the rise is attributable to higher demand from Afghanistan and uncertainty about planting of the new crop due to the damage caused by the floods. Price of rice have also risen in recent months. The price impact on overall food consumption is expected to be substantial.

Floods cause job losses

Natural disasters are indiscriminate in their destruction and leave a large portion of the population vulnerable to diseases, job losses, homelessness etc. The earthquake of October 2005, resulted in a loss of more than 324,000 jobs, which was around 29 percent of the total employed population in the affected districts of Azad Jammu & Kashmir and Khyber-Pakhtunkhwa. The largest job losses were in agriculture, small businesses, shops and construction sectors.

The people most severely affected were predominantly small farmers and unskilled labourers. They are amongst the most vulnerable and live below or just above the poverty line. More than 60 percent lost access to their primary livelihood. About 5.3 million jobs were affected, estimates the ILO. They are faced with a drop in their already low income, and will likely fall into extreme poverty. Problems have compounded as the affected areas are amongst the poorest in Pakistan.

Pakistan is already suffering from low social development indicators. In terms of *Human Development Index* it ranks 141 out of 182 countries, and 124 out of 155 countries in the *Gender Development Index*. 22.3 percent of the population lives below the poverty line.

Poverty to rise

Poverty to some extent can be reduced, if targeted interventions focus on the recovery possibilities at the local level, involving the community. As the bulk of the affected people are from rural areas, agricultural revival is essential. It will take considerable time for people to be gainfully reemployed in the agricultural sector, and rural livelihoods are expected to be severely impacted. The government will have to focus on promotion of non-farm income generating opportunities, so that people who have lost their source of livelihood can find alternate work and be in a position to earn some income.

Support of financial institutions

The affected segment of population has little access to formal financial services, and have small savings or none to rebuild asset base. The financial institutions will have to provide special support to the agriculture, and small & medium enterprises (SMEs), so to restart the process of income generation. The State Bank of Pakistan has constituted committees in the areas of SMEs, microfinance and agriculture to develop a strategy for the settlement of existing loans and provision of fresh credit in the affected areas.

The Governor, State Bank of Pakistan recently said that the State Bank in consultation with banks had taken the following initiatives for revival of economic activity in the flood affected areas: -

- Banks/DFIs are encouraged to reschedule/restructure agriculture and SME loans/advances to such borrowers where the possibility of recovery exists.
- Initiated a concessional financing scheme for Canola Cultivation in the flood affected potential districts for Rs500 million refinance and 30 percent first loss sharing.
- Launched a refinance scheme of Rs10 billion for fresh agri production loans at a subsidized rate, almost half of the market rate at 8 percent, in 78 districts identified by NMDA.

Microfinance has played a significant role in Bangladesh floods by helping clients manage



the impact of disasters. Because Bangladesh has a history of frequent natural disasters, its microfinance industry has well conceived response mechanisms.

In their paper, *'Can Microfinance meet the poor's financial needs in times of natural disaster?'* Joan Parker & Geetha Nagarajan, the authors state, Bangladesh differs from many microfinance contexts in that it is characterized by a significant number of broad-based, well-managed, flexible MFIs. When combined with an environmental context of frequent rapid-onset natural disasters, we find a history of thoughtful innovation on microfinance products and mechanisms to protect clients from natural disasters.

Bangladesh  
experience

Microfinance efforts in Bangladesh are also complemented by an extensive disaster preparedness and response system which provides an institutional framework in times of emergency. This context has both drawn MFIs further along the preparedness path, and allowed the MFIs to depend upon complementary services provided by other institutions.

The Bangladesh experience also illustrates a range of internal and external mechanisms the MFIs have used to both prepare for and respond to natural disasters. To list them briefly:

- Development of Disaster Loan Funds – both for individual MFIs and for groups of MFIs;
- Relationships with disaster warning and disaster response institutions;
- Involvement of commercial banks in disaster response;
- Involvement of citizens in disaster response;
- Development of staff incentives to keep staff in the field and hard at work after disaster strikes;
- Use of high-tech communication methods to keep field staff and headquarters in touch; and
- Coordination with early warning systems and monitoring of branches located in vulnerable areas.

Pakistan has been a late starter in this industry, but has made considerable developments in microfinance. The coverage and scope of their operations has generally been rather limited and lags behind other countries in the region such as Bangladesh and India. Despite a rise in the total number of borrowers (around 2 million) the outreach is still far behind the total potential market of 18–20 million households. For a country, where nearly 23 percent of the people live below the poverty line, this outreach is very low.

Micro  
finance  
institutions

The floods have hit Pakistan hard. Its the poor who has had to bear the brunt of this natural disaster. Institutions that serve the poor are an important part of the post disaster response. Microfinance institutions can play their due part by exploring and expanding the services that are needed after a disaster such as the floods. They are channeling their efforts to restore livelihoods in the flood affected communities.

In Pakistan, 86 branches out of the 625 branches of microfinance institutions located in the affected areas have been partially or completely damaged. The impact of the floods on the financial sector has been assessed primarily through the impact on the banking sector, the microfinance sector and the non-bank financial institutions sector. The estimated physical damages to MFIs amounts to Rs34 million.

NPLs of  
the  
affected  
areas

Within the microfinance sector, total NPLs in the affected areas have been estimated to have increased from Rs304 million (\$3.6 million) to Rs2,156 million (\$25.3 million). NPLs in the MFIs represent just over 40 percent of the total NPLs with the larger share coming from MFBs. Within the MFIs, the largest quantitative increase has been felt in Sindh (representing 56 percent of total NPLs) followed by Punjab (with 38 percent). The agriculture sector has been by far the worst affected, representing 69 percent of total NPLs for both MFIs and MFBs combined, states the Asian Development Bank and World Bank Report on the Pakistan Floods.

SBP provides relief

The State Bank of Pakistan in its circular BSD Circular No. 06 dated November 2, 2010 has provided relief measures for agriculture and SME loans/ advances of flood affected areas. It states, in order to provide relief to the borrowers of flood affected areas identified by the National Disaster Management Authority (NDMA), banks/DFIs are encouraged to reschedule/ restructure Agriculture and SME loans/ advances to such borrowers, as per existing Prudential Regulations (PRs) of Agriculture and SME financing, where the possibility of recovery exists.

For all such rescheduled/restructured loans and advances, Banks/DFIs may defer loan provisioning up to 31st December 2011. However, classification of such loans shall be done as per criteria laid down in the relevant PRs. This relaxation is available for loans and advances which become non-performing since July, 1, 2010 in the affected areas identified by NDMA. Loans/advances classified before this date shall not qualify for this relaxation.'

Public finances to be affected

Many of the economic challenges facing Pakistan preceded the floods. The floods have served to worsen the situation. Public finances are likely to be affected due to large scale increase in flood related expenditure and balance of payments is likely to come under pressure as exports would slow down and imports accelerate.

In the last fiscal year 2009-10, the government had predicted a fiscal deficit of 5.1 percent of GDP, however, final estimates show that the deficit had risen to 6.3 percent of GDP. For FY11 the government had earmarked for larger increase in revenues with the introduction of Reformed General Sales Tax. The proposed GST system is expected to increase the overall tax to GDP ratio from the present 9 percent to about 12 percent in the next 3–5 years. As there has been a delay in implementing the reformed General Sales Tax and floods surcharge, the government may revise downward the revenue target for the year.

In FY2010, fiscal performance fell short of the budget targets. The fiscal deficit at 6.3

Fiscal performance

percent of GDP was substantially higher than the 5.1 percent target for the year. Public Sector Development Programme was slashed during the year, cutting heavily into infrastructure outlays and thus affecting the improvements needed to support investment in the sector. On the other hand, increases in security spending and a rise in energy related subsidies (power related subsidies jumped from a budgeted 0.5 percent of GDP to 1.0 percent, as tariff increases were insufficient for cost recovery) resulted in much higher current expenditures than budgeted.

While expenses on subsidy, defence, interest and pension rose, alongwith the operating expenses of the federal government, the government's tax revenues contracted as federal tax collection fell short of the target in FY2010. Thus federal government borrowing rose.

For FY2011, as flood related expenditures rise, it would increase the demand for budgetary resources, initially because of the costs of rescue and relief operations, and later because of the huge reconstruction needs. Revenue generation assumes added significance in view of the massive reconstruction requirements. The expected developments could lead to a higher fiscal deficit from the targeted 4.0 percent if the tax base remains narrow.

## Macroeconomic Indicators

	2009-10	2010-11 (%)	
		Pre-Floods	Post-Floods
Real GDP Growth	4.1	4.3	2.8
CPI Inflation	11.7	11.5	13.5
Current Account Deficit/GDP	(-2.0)	(-2.5)	(-3.1)
External Debt/GDP	31.6	30.7	31.8
Merchandise Exports US dollars (% Change)	2.7	4.7	3.0
Merchandise Imports US dollars (% Change)	(-2.2)	6.9	8.7

Source: IMF Country Report, September 2010

A higher fiscal deficit would imply a larger build up of public debt, having adverse fiscal

and economic implications for future. To avoid a large scale destabilization effect on the economy, the federal and provincial governments are in the process of reallocating their budgetary expenditures towards relief and rehabilitation activities.

A careful balance needs to be established between the need for an early rehabilitation of infrastructure and ensuring economic stability. An accelerated reconstruction effort, in the absence of adequate inexpensive financing, can force the government to borrow heavily from the banking system fueling inflation and building-up the stock of more expensive debt, which can further destabilize the economy, states the joint World Bank & Asian Development Bank Report.

Balance of payments may weaken because of the floods. A slight deterioration in the current account deficit was envisaged for FY11, reflecting higher food imports (sugar, edible oil etc) as well as increased imports to support an anticipated improvement in economic activity. The Annual Plan had targeted the current account deficit as a proportion of GDP at 3.4 percent in FY11, (while SBP projected it between 3.0 – 4.0 percent), against 2.0 percent provisionally estimated for FY10. The outlook is expected to worsen post floods, as the trade deficit may be higher because of

substantial losses in agricultural production and the subsequent need to import.

During the period July-October 2010, the balance of trade widened to \$5.08 billion against the corresponding figure of \$4.54 billion in the same period of 2009. There was a substantial jump in the import of sugar, soyabean oil, raw cotton, among others. The *IMF Country Report* published in September 2010, states, ‘although the major export plants seem to have escaped physical damage, cotton and textiles exports will likely be lower if the cotton crop is affected significantly. The higher-than-expected trade deficit will be compensated in part by rising remittances, which may approach a record \$10 billion.’

Non-performing loans (NPLs) are expected to rise, especially for banks with large exposure to the agricultural sector. NPLs of all banks and development finance institutions stood at Rs508.8 billion as on 30.09.2010.

In FY2010, banks were able to achieve more than 95 percent of agri credit disbursement target of Rs260 billion. Banks disbursed Rs248 billion. The floods caused huge losses to infrastructure, standing crops, and the earning assets of rural household. As a result, out of the total outstanding agri advances in affected areas of Rs53 billion, Rs32 billion had become non-performing.

## Major Lenders only Country-wise update of Foreign Assistance for Flood Affectees\*

Sr. #	Country / Agency	Total Commitment (\$ Mn)	Grant (\$ Mn)		Soft Loan (\$ Mn)		In-Kind (\$ Mn)		Implementing Agency	
			Committed Pipeline	Disbursed	Committed	Disbursed	Committed Pipeline	Received	UN/INGOs	GoP
1	ADB	3.22		3.00				0.22		3.22
2	Australia	67.50	67.50	TBD			Three Plane load of relief goods	Sent two plane	67.50	
3	Austria	7.00		7.00					7.00	
4	Bahrain	5.00					2.00	3.00		5.00
5	Canada	33.00	33.00						33.00	
6	China	250.00	28.75	0.19				21.03	200.00	50.00
7	Denmark	33.00	21.00	12.00					33.00	
8	EU	187.50	100.00	87.50					187.50	
9	Finland	5.67		5.67					5.67	
10	France	2.63	1.37	1.02			72 million tonnes of relief goods	All received	2.63	
11	Germany	43.75	6.25	37.50					43.75	
12	IDB	11.02	1.02		10.00					11.02
13	India	25.00	25.00						25.00	
14	Iran	101.20					100.00	1.20	1.20	100.00
15	Italy	8.25	2.75	5.50					8.25	
16	Japan	19.80	19.00					0.80	19.00	0.80
17	Kuwait	10.00						10.00	5.00	5.00
18	Kuwait Private Sector	15.50					15.50			15.50
19	Netherlands	43.25	34.86	8.39					43.25	
20	Norway	19.00					19.00		19.00	
21	Oman	5.00					5.00		5.00	
22	Qatar Private Sector	5.04					3.62	1.42		5.50
23	Saudi Arabia	100.00					55.00	45.00	95.00	5.00
24	Saudi Fund of Development	23.33	23.33						23.33	
25	Saudi Public Fund Relief	242.00					242.00			242.00
26	Spain	7.46	2.56	4.90					7.46	
27	Sweden	23.01	9.36	13.65					23.01	
28	Switzerland	7.28	2.92	4.36					7.28	0.33
29	Turkey	45.00		10.00				35.00	35.00	10.00
30	Turkey private/ public fundraising	130.90					130.90			130.90
31	UAE Government	5.15		0.15				5.00		5.15
32	UAE Private Sector	19.60					19.60			19.60
33	UK / DFID	117.67	69.67	48.00			tents, blankets, water containers, shelter kits, water purification tablets	All received	117.67	
34	UN	29.00		29.00					29.00	
35	US / USAID	381.52	313.52	TBD			Twelve flights plane load of goods including Boats, Shelter and settlements, water sanitation and hygiene, plastic sheeting, blankets	68.00	381.52	
36	World Bank	1.30					1.10	0.20		1.30
	<b>Total</b>	<b>2074.04</b>	<b>768.42</b>	<b>290.88</b>	<b>10.00</b>	<b>0.00</b>	<b>599.75</b>	<b>204.72</b>	<b>1439.86</b>	<b>635.29</b>

\* December 08, 2010

## Impact of Floods on the Agricultural Sector

Severe  
flooding

Heavy monsoon rains caused the most severe flooding in Pakistan's history. The floods affected agricultural lands and destroyed the livelihood of subsistence farmers. Around 80 percent of the affected population depends on the agri sector to provide for their families. Millions of hectares cultivable land, (government estimates 2.4 million hectares) including standing crops (e.g. rice, maize, sugarcane, cotton, orchards and vegetables) livestock, fisheries and forestry have been damaged. Basic infrastructure, such as tubewells, water channels, storage tanks, agricultural implements have also been damaged or destroyed. Around 1.2 million animals have died, which is a great loss for the poor households. In addition, 14 million livestock are at risk due to fodder shortages. Poultry deaths is estimated at around 6 million.

According to the Food & Agriculture Organisation (FAO), overall production loss of sugarcane, paddy and cotton was estimated at 13.3 million metric ton. There has been a significant loss of food commodities held in warehouses owned by government, traders, households and humanitarian agencies. Current estimates place losses in government warehouses at around 140,000 MT. The loss of stored seeds, including those needed in September/October to produce wheat, has rendered farming families extremely vulnerable.

Crops  
damaged

According to a report, '*Preliminary Rapid Damage Assessment in the Agriculture Sector*', conducted by the Agriculture Cluster: August 2010, a total of 1.31 million hectares of field crops were damaged. Punjab was the worst affected 0.66 million hectares, followed by Sindh 0.36 million hectares, Khyber-Pakhtunkhwa 0.19 million hectares, Balochistan 0.09 million hectares and AJK 0.01 million hectares. The main losses have been recorded in field crops, of which, cotton, sugarcane, fodder crops and rice were found as worst affected crop of the current kharif season. Besides damage to growing crops and fields, the farming community also suffered

heavy losses in livestock and irrigation infrastructure.

The wheat crop, which is cultivated in winter, was harvested before the floods. Farmers were in the process of preparing their land for planting when the floods began. Severe flood has damaged the lands, as in some areas, the fertile top layer of soil has been washed away, while in other areas, the land is still water logged or covered in silt and needs to be cleared.

Wheat  
planting

The wheat planting season in most parts of the country starts from the beginning of October and families in many areas have started returning to their land. In Sindh, many wheat planting areas still remain under water, which impedes planting at this stage. Availability of critical inputs is essential to prevent any drastic loss in yield. FAO is currently assisting 280,000 households receive seeds and fertilizers to meet the Rabi wheat planting season, ending in November.

In 2009-10 Pakistan had a good wheat crop of 24 million tonnes and after consumption and setting aside some reserves, it still had 2 million tonnes of surplus for export. But after the flood waters had washed away grain stocks, the government deferred plans to export its surplus. Estimates place losses at 725,000 tonnes of wheat in the flooding.

Rice crop

Rice is a major kharif crop grown in the three provinces, Punjab, Sindh and Khyber-Pakhtunkhwa. The crop was badly hit by the floods in terms of damages to standing crop as it is cultivated in low lying riverine belt exposed to floods and heavy rains. In Sindh, of the districts surveyed, the report shows that 55 percent of the standing crop was damaged, while in Khyber-Pakhtunkhwa rice was the most flood affected standing crop, as nearly 75 percent has submerged to various degree by flood water, with 100 percent production losses in most of the flooded areas. In Punjab, of the districts surveyed, rice crop losses was to the extent of 15 percent.

For 2010-11, rice production target was fixed at 6.17 million tons. This was 10.3 percent less than the 6.88 million tons output recorded in 2009-10. In FY2009-10, four million ton of rice was exported at \$2.17 billion. As the country lost around 2–2.4 million metric tons of rice because of the floods, exports are expected to be affected, but because of previous year’s carry over stocks, damage to export levels is likely to be less. The country was to ship 3.8 million tons this year.

Cotton crop

Cotton growers have suffered enormous losses. The cotton crop was at a critical stage of growth i.e. boll formation. The floods and inundation have caused premature shedding and in other places the crop has been completely washed away by flash floods.

Pakistan had hoped to produce 14 million bales of cotton in 2010-11 season, compared with about 12.7 million bales in 2009-10. After the floods damaged the crop, government and industry officials now estimate output of about 10.5–11.5 million bales. The decreased production is likely to increase cotton imports by 3–4 million bales. Imports are necessary to meet the demand of the textile industry.

Sugarcane crop

The floods have also affected the sugarcane crop. Estimates of the extent of damages caused to the cane crop varies, but various group put it around 12–15 percent. It is used as raw material by sugar industry and its leaves and stalk are used as animal fodder.

The 2010-11 crop, was targeted to produce 53.7 million tonnes of sugarcane. This was expected to produce 3.8 million tonnes of white sugar before the floods struck. Output of sugar is now expected at about 3–3.6 million tonnes against an annual demand of 4.2 million tonnes.

The Economic Coordination Committee of the Cabinet has decided to withdraw 25 percent regulatory duty on import of raw sugar and has allowed the private sector to import the commodity. Trading Corporation of Pakistan would have no role in the import of sugar.

Vegetables/fruits damaged

Besides losses of major crops, the floods also affected fodder crops, maize, vegetables, fruit orchards, livestock and irrigation infrastructure. This has vastly affected the livelihood of the predominantly agrarian flood affected communities. The losses to vegetable crops have resulted in shortages and higher prices in the local market. In Khyber-Pakhtunkhwa, 59 percent of the total planted area of vegetable was damaged. Mung and mash are the major pulse crops of southern part of KP, Punjab and Sindh. In KP, there was total loss in the surveyed districts. Fruit orchards suffering losses due to the floods were mango, citrus and guava in Punjab, apples and peaches in KP and banana in Sindh province. No losses to fruit orchards were reported from Balochistan.

Livestock suffers

The floods caused significant damages/losses to the livestock sector in all provinces of Pakistan. FAO estimates that 1.2 million heads of livestock were lost, not including the 6 million poultry lost. Animal losses varied across the provinces. In general losses were greatest in Sindh were on average two third of farm animals were reportedly lost and lowest in the Punjab were losses were substantially lower at about one third on average. People are selling their animal at low prices to fulfill their cash needs. Losses are high for poultry, with households reporting that more than 70 percent of their birds drowned by the flood water.

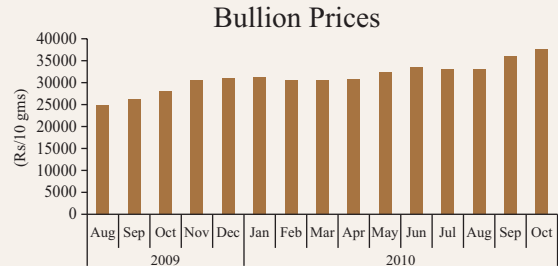
Floods have caused extensive damage to almost all types of irrigation infrastructure. Canals, irrigation channels and water courses have been eroded and flood water has caused sedimentation/siltation. These need to be repaired and de-silting to take place to restore water availability to standing crops. A preliminary assessment report for flood affected areas shows that irrigation infrastructure suffered greatly in Punjab, followed by Khyber-Pakhtunkhwa and Sindh. The maximum damage to water courses, tubewells, were reported in Punjab, while maximum damage to primary irrigation structures, and secondary irrigation channels were recorded in Khyber-Pakhtunkhwa.

## Rising Gold Prices

Gold has hit record high in current weeks, crossing \$1387 an ounce in October 2010, boosted by demand from investors for a store of value after the US Federal Reserve signaled further easing of monetary policy. In December 2009, gold had risen above \$1200 an ounce because of dollar weakness and expectations for central banks to diversify reserves into gold driving prices higher. Since then it has steadily risen, due to a number of factors like, fears over the contagion of debt issues in the euro zone, underlying fears over financial market stability and sovereign risk combined with dollar weakness, uncertainty on the economic outlook and fear of inflation.

The key price drivers for rising prices of gold include among others: -

- Increased demand for gold as an alternative asset.
- Rising interest in commodities, including gold from investment funds in recent years has been a major factor behind bullion's rally to historic highs.
- Gold is a popular hedge against currency market volatility. Analysts say gold's strong performance this year has been largely driven by concerns over the stability of all currencies, though primarily the US dollar.
- Gold is considered a safe haven. Financial market uncertainty as seen this year, in the case of burgeoning debt problems for Greece and other euro zone economies, tends to boost inflows to gold.
- Central banks hold gold as part of their reserves. Some central banks, mostly in Asia, have shown a tendency to add to their gold reserves, with Thailand and Bangladesh being some of the most recent countries to purchase bullion. This has also provided a major support to prices.
- Institutional investors such as pension funds are increasingly looking at gold because of its appeal as a store of value and hedge against potential inflation.
- In Pakistan gold prices have steadily risen to reach record highs.



Goldman Sachs Group Inc, the investment bank and commodities broker, has raised its 12 month price target for gold to \$1650 an ounce, and three month forecast to \$1400. It expects the US Federal Reserve to announce a return to quantitative easing measures, as early as November, which would act as a strong catalyst to carry gold prices to the higher levels.

Citigroup recently revised its short and medium term gold forecast to \$1450 per ounce, pointing to safe haven demand for gold in light of ongoing concerns over global currency and deflation. However, analysts went on to say that they have less conviction for sharper moves one year from now. Likewise, Natixis, a French investment bank, predicts that the gold price will slowly fall in 2011 as the global economic recovery continues. It expects investment demand for the yellow metal to eventually prove insufficient to maintain current levels, as negative real interest rates disappear and other asset classes begin to offer more attractive potential returns. Accordingly, it predicted the gold price will average \$1050 in 2011.

Delegates at the London Bullion Market Association's annual conference raised their already bullish forecast for the gold price, with expectations for the price to hit \$1450 an ounce by next September.

AngloGold Ashanti, the world's third largest gold miner, forecast gold prices – already at record highs – could rise by between \$70-\$100 an ounce annually over the next five years as demand from investors accelerates. The forecast is slightly below forecasts by world No. 1 gold producer Barrick Gold's prediction to \$1500 plus next year.

## Islamic Banking at a Glance

(Rs bn)

	2003	2004	2005	2006	2007	2008	2009
Assets	13	44	71	119	206	276	366
% of Banking industry	0.5	1.4	2.1	2.9	4.2	4.9	5.6
Deposits	8	30	50	84	147	182	264
% of Banking industry	0.4	1.2	1.9	2.8	4.1	4.8	6.1
Financing & Investment	10	30	48	73	138	187	226
% of Banking industry	0.5	1.3	1.8	2.4	3.6	4.4	4.7
Liabilities	11	39	64	103	176	240	324
Capital / Equity	2	5	8	16	29	36	42
Markup Income	0.4	1	3	6	13	22	32
Markup Expenses	0.2	0.5	2	3	7	11	17
Net Markup Income	0.2	0.6	2	3	6	11	14
Provision Expenses	-0.002	0.006	0.2	0.2	0.8	1	3
Non Markup Income	0.3	0.6	1	1	2	2	4
Operating Expence	0.3	0.8	1	3	6	10	13
Profit (B.T)	0.2	0.4	1	0.8	2	2	2
Profit (A.T)	0.2	0.3	1	0.9	2	2	2
Full Fledged Islamic Banks	1	2	2	4	6	6	6
Conventional Banks with Islamic Banking Branches	3	7	9	12	12	12	13
Total No. of Branches	17	48	70	150	289	433	561

Source: State Bank of Pakistan

### Islamic Banks Operating in Pakistan as on December 31, 2009

	No. of Branches	Commenced Operation
1. Al baraka Islamic Bank	29	1991
2. Bank Islami Pakistan Limited	70	March 31, 2005
3. Dawood Islamic Bank Limited	40	April 27, 2007
4. Dubai Islamic Bank Pak Limited	36	March 20, 2006
5. Emirates Global Islamic Bank Ltd	60	December 20, 2004
6. Meezan Bank Limited	181	March 20, 2002



### Performance of Islamic Banks Operating in Pakistan

(Rs Bn)

Banks	Assets			Equity			Deposits			Advances			Investment		
	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009
Meezan Bank	67.2	85.3	124.2	5.7	6.3	9.1	54.6	70.2	100.3	34.6	39.5	44.2	10.5	14.5	23.3
Dubai Islamic Bank	21.3	32.0	35.4	4.3	5.1	6.0	16.1	25.5	28.0	11.3	18.1	20.6	3.0	3.0	2.8
Al Baraka Islamic Bank	22.1	24.2	29.3	2.4	2.4	2.7	17.0	18.3	22.6	12.6	14.4	14.8	1.1	1.1	1.7
Bank Islami	14.4	19.1	34.3	3.2	5.2	4.7	9.9	12.5	28.0	4.0	6.5	13.3	3.9	5.0	6.8
Emirates Global Islamic Bank	8.9	16.5	19.8	3.8	4.1	3.5	4.6	10.9	15.1	2.6	7.8	9.4	2.3	2.8	3.4
Dawood Islamic Bank Limited	6.8	9.6	13.1	3.7	4.1	4.8	2.9	5.1	6.8	3.7	5.6	4.8	1.3	2.0	2.9
<b>Total</b>	<b>140.7</b>	<b>186.7</b>	<b>256.1</b>	<b>23.1</b>	<b>27.2</b>	<b>30.8</b>	<b>105.1</b>	<b>142.5</b>	<b>200.8</b>	<b>68.8</b>	<b>91.9</b>	<b>107.1</b>	<b>22.1</b>	<b>28.4</b>	<b>40.9</b>

	Interest Income			Interest Expense			Net Interest Income			Non Interest Income			Revenue		
	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009
Meezan Bank	4574	6803	10102	2452	3088	4970	2122	3715	5132	1348	708	1598	3470	4423	6730
Dubai Islamic Bank	1120	2724	3647	469	1377	1806	650	1346	1841	336	336	365	986	1682	2206
Al Baraka Islamic Bank	1493	1765	2556	1090	1334	2041	403	431	515	264	204	267	667	635	782
Bank Islami	602	1469	2194	304	729	1222	298	739	972	140	196	343	438	935	1315
Emirates Global Islamic Bank	381	1060	1914	125	598	1235	256	462	679	64	95	302	320	557	981
Dawood Islamic Bank Limited	250	855	1132	58	403	651	192	452	481	9	46	57	201	498	538
<b>Total</b>	<b>8420</b>	<b>14676</b>	<b>21245</b>	<b>4498</b>	<b>7529</b>	<b>11925</b>	<b>3921</b>	<b>7145</b>	<b>9620</b>	<b>2161</b>	<b>1585</b>	<b>2932</b>	<b>6082</b>	<b>8730</b>	<b>12552</b>

	Admn Expense			Operating Profit			Provision/Other Expense			Profit/Loss (B.T)			Profit/Loss (A.T)		
	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009
Meezan Bank	1756	2627	3530	1714	1796	3200	445	804	1460	1269	992	1740	963	621	1025
Dubai Islamic Bank	1454	1791	1724	-468	-109	482	101	162	130	-568	-271	352	-369	-182	227
Al Baraka Islamic Bank	335	573	704	332	62	78	18	141	458	314	-78	-381	246	-73	-281
Bank Islami	507	1028	1755	-69	-93	-440	32	136	122	-100	-229	-563	-37	-53	-479
Emirates Global Islamic Bank	395	950	1411	-75	-393	-430	8	-2	369	-84	-391	-799	-57	-260	-564
Dawood Islamic Bank Limited	166	434	686	35	64	-148	2	4	257	32	60	-405	51	33	-293
<b>Total</b>	<b>4613</b>	<b>7403</b>	<b>9810</b>	<b>1469</b>	<b>1327</b>	<b>2742</b>	<b>606</b>	<b>1249</b>	<b>2796</b>	<b>863</b>	<b>83</b>	<b>-56</b>	<b>797</b>	<b>86</b>	<b>-365</b>

	Cost of Fund			Intermediate Cost			Pre-Tax Margin			Net Profit Margin			Net Interest Margin		
	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009
Meezan Bank	5.1	4.7	5.4	3.7	4.0	3.9	21.4	13.2	14.9	27.8	14.0	15.2	4.4	5.7	5.7
Dubai Islamic Bank	4.6	6.6	6.7	14.2	8.6	6.4	-39.0	-8.9	8.8	-37.4	-10.8	10.3	6.5	6.5	6.8
Al Baraka Islamic Bank	6.4	6.9	9.0	2.0	3.0	3.2	17.9	-4.0	-13.5	36.7	-11.5	-35.0	2.4	2.3	2.3
Bank Islami	5.1	6.4	6.0	8.6	9.0	8.6	-13.5	-13.8	-22.2	-8.4	-5.7	-36.4	4.4	6.0	4.9
Emirates Global Islamic Bank	5.4	7.4	9.2	17.1	11.7	10.6	-18.7	-33.9	-36.1	-17.8	-46.7	-57.5	7.7	4.6	4.7
Dawood Islamic Bank Limited	4.0	10.1	10.0	11.5	10.8	10.6	12.4	6.6	-34.1	25.4	6.6	-54.5	6.4	6.4	5.0

	ROE			ROA			ROD			Non Interest Income			Interest Spread		
	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009
Meezan Bank	18.4	10.3	13.3	1.7	0.8	1.0	2.2	1.0	1.2	38.8	16.0	23.7	4.5	5.7	5.7
Dubai Islamic Bank	-9.4	-3.9	4.1	-2.5	-0.7	0.7	-3.6	-0.9	0.8	34.1	20.0	16.5	6.6	6.5	6.7
Al Baraka Islamic Bank	10.6	-3.0	-3.0	1.2	-0.3	-1.1	1.6	-0.4	-1.4	39.6	32.1	34.1	2.6	2.4	2.3
Bank Islami	-1.4	-1.3	-9.7	-0.4	-0.3	-1.8	-0.6	-0.5	-2.4	32.0	21.0	26.1	3.7	5.4	5.0
Emirates Global Islamic Bank	-1.8	-6.6	-15.0	-1.3	-2.0	-3.1	-2.5	-3.4	-4.3	20.0	17.1	30.8	6.0	3.3	4.1
Dawood Islamic Bank Limited	2.8	0.9	-6.6	1.5	0.4	-2.6	3.5	0.8	-4.9	4.5	9.2	10.6	4.4	2.0	1.7

	Cost of fund Earning Assets			Admn Expenses/Employee			Staff Branch			Profit(A.T) / Branch			NPL/Gross Advances		
	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009	2007	2008	2009
Meezan Bank	5.1	4.7	5.5	0.9	0.9	1.1	20	17	16	9.6	3.7	5.1	1.8	3.7	4.8
Dubai Islamic Bank	4.7	6.6	6.7	2.6	3.0	3.1	33	26	16	-21.7	-7.9	6.5	0.3	1.9	3.7
Al Baraka Islamic Bank	6.6	7.0	9.2	0.9	2.5	1.3	20	16	18	13.6	-2.5	-9.7	2.0	6.3	9.1
Bank Islami	4.4	5.9	6.1	0.9	0.9	1.2	16	12	14	-1.0	-0.5	-4.7	3.2	3.5	7.8
Emirates Global Islamic Bank	3.8	6.0	8.6	1.7	1.9	2.4	23	12	10	-5.7	-6.5	-9.4	-	0.2	13.8
Dawood Islamic Bank Limited	1.9	5.7	6.8	1.9	1.9	1.5	18	11	9	10.2	1.6	-5.9	-	1.1	1.8

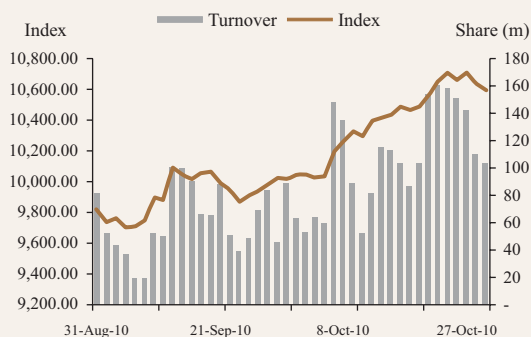
Source: Annual Reports of the Banks

## Market Analysis

### Market Review – September To October 2010

The market during the period was relatively flat during September but picked up momentum during October on the back of positive news flows and decent quarterly results. Overall, the KSE-100 Index during September to October, 2010 gained 785 points or 8.0 percent to close at 10,598 on average daily turnover of 84.35m shares.

KSE-100 Index (September-October 2010)



The first few days of September was mixed as volumes were on the downslide. With no positive development on the margin product, a number of KSE members began a campaign to change the Articles of Association of the KSE to allow a member to be elected Chairman instead of a regulator (SECP) appointed one. On the macroeconomic front, the government announced revised GDP growth target of 2.5 percent, inflation forecast of 15-20 percent and fiscal deficit of 6-7 percent of GDP for FY11, reflecting the impact of the current floods.

The second week of September was a shortened week due to Eid ul-Fitr holidays and thus, the activity was listless. The market received a boost during the middle of the week as there were rumors that there would be further discussions after the holidays on the margin trading system. In addition, the FBR released draft rules regarding Capital Gains Tax stating that losses arising from wash sales,

cross trades in related accounts and tax swap sales will not be adjustable against gains.

Record remittances were recorded in the month of August of US\$ 933 million while on the other hand; August 2010 inflation was posted at 13.23 percent YoY on the back of food and energy inflation. The International Monetary Fund has set four pre-conditions for continuing with Pakistan's \$11.3 billion standby arrangement (SBA) and withheld the release of two remaining tranches of \$2.6 billion till the government meets the criteria. The four conditions are: 1) implementation of reformed GST; 2) power sector reforms; 3) additional autonomy for the central bank; and 4) resolution of inter-corporate debt issue.

The market began the post-Eid holiday break on a positive note due to expectations that the SECP Policy Board meeting on September 15 would approve the much anticipated margin product. The KSE-100 Index closed above the 10,000-mark for the first time since the beginning of August. As expected, the SECP Policy Board approved the concept paper of the margin trading system but with added risk management measures. In addition, the timetable for implementation remained unsure, resulting in subdued reaction by investors in the aftermath of the meeting.

Major macro-economic development during the week was the GoP's plan to introduce the reformed GST on October 1 via Presidential Ordinance on the same day to satisfy IMF conditions. On the corporate front, there was some positive news that OGDC had completed the installation of the compressors at Qadirpur field a few days earlier than expected. This will eventually help boost the production to 600 mmcf of gas from the current 450 mmcf. On the political front, the murder of Imran Farooq in London on the night of September 16 led to tension in Karachi the next day, but the market was resilient as it received support from institutional investors.

Economic targets revised

The KSE-100 Index ended the week up by 1.7 percent to 10,052 on September 17.

The fourth week of September saw the market become lackluster as the excitement over the developments on the margin trading system began to sputter due to the concerns over the possibility of a rate hike in the next Monetary Policy Statement and precarious political situation. The KSE-100 Index saw a WoW decline of 1.4 percent to close at 9,909 on September 24.

The final week of September saw the Index gain 1.0 percent WoW to close above the 10,000-level despite the 50 bps hike in the policy rate to 13.5 percent by the SBP, as corporate results announced by various Attock Group companies were outstanding which helped prop the market.

The market was mainly bullish during October 2010 due to most major quarterly results being in line with expectations and positive developments regarding the Government-Judiciary stand-off and U.S.-Pakistan strategic dialogue.

Market  
bullish

The market was dull and subdued for the first few days of the month under review because of reaction by investors to the 50 bps hike in the policy rate to 13.50 percent by the SBP at the end of September, rising T-bill yields, expectations of new tax measures to finance flood relief and rehabilitation and alarming levels of government borrowing from the SBP to finance the fiscal deficit. From the end of September to October 6, the KSE-100 Index gained only 16 points to 10,029.

From October 7 to 15, the bourses found some renewed momentum on the back of positive news flow and foreign inflow. The following news flow had a positive impact on investor sentiments:

- The news of EU duty relief on goods imported from Pakistan including textiles;
- Reported price hike of cement in the north zone by about PKR 25 per 50 kg bag;

- Rising international crude oil prices all had positive impact on investor sentiments;
- Ogra notifying higher wellhead gas prices for 1HFY11 period;
- IMF suggesting that it may relax the fiscal deficit target by 0.7 percent with an assurance to pay out US\$ 1.8bn by December if the government meets the targets;
- 1QFY11 remittances posted a record high of US\$ 2.65bn, up by 13.5% YoY.

There were some negative macroeconomic developments reported during this period such as the higher than expected increase in CPI during September 2010 at 15.7 percent YoY and rising yields in the recent PIB auction held on October 13, 2010.

The third week of the month saw the KSE-100 Index continue to consolidate its gains from the previous week and hence, the Index was mainly moving sideways posting minor gains. Investors reacted positively to developments such as the Economic Coordination Committee of the Cabinet approving oil price deregulation plan that would have some benefit for the mid and downstream sectors, a US\$ 447m current account surplus posted in September 2010 and the Supreme Court's decision on October 21 to send back to parliament for review the clauses in the 18th Amendment pertaining to the procedure of selecting judges for the higher judiciary which appeared to have lower the political temperature. The KSE-100 Index gained 220 points to end the week at 10,652.

The KSE-100 Index began the final week of October on a positive note as the strategic dialogue between the U.S. and Pakistan in Washington was viewed as sanguine due to the announcement of military assistance of US\$ 2 billion and that Pakistan was able to effectively communicate its perspective on the continuing war on terror. However, the Index suffered a minor jolt the next day on October 26 as the SBP released its Annual Report on the economy for FY2010. The SBP mentioned in its outlook for FY11 that the

macroeconomic targets originally envisaged in the FY11 Annual Development Program will undergo a setback due to the floods. The remainder of the week, the market was range bound despite good quarterly announcements of a number of major stocks.

Regional  
Valuation

The Pakistan market PE at 7.04x is trading at a 48.0 percent discount to the regional average of 13.53x. Based on dividend yield, Thailand is the most attractive at 6.76 percent as compared to the regional average of 2.59 percent, followed by Pakistan (5.84 percent) and Taiwan (3.54 percent).

Looking  
Ahead

Another monetary policy statement is expected next month, the last one before the end of the calendar year. Given the inflationary pressure in the economy due to higher food prices and huge government borrowing from the SBP for budgetary support, we believe that another 50 bps hike in the policy rate is possible. The

bourses will also be impacted by any major developments in the political and/or economic situation, as talks with the IMF over the next tranche of US\$1.7 billion will begin on November 1.

### Regional Valuation Comparison

Country	12m F PEx	12m F Dividend Yield (%)
China	16.05	1.21
Hong Kong	13.87	2.32
India	15.09	0.94
Indonesia	14.86	1.96
Malaysia	13.81	2.63
Pakistan	7.04	5.84
Philippines	13.97	2.42
Singapore	13.41	2.83
South Korea	9.35	1.29
Taiwan	12.58	3.54
Thailand	12.32	6.76

Source: Thomson One Analytics, Date: October 14, 2010

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

**Book/Report Reviews**

*Institutional Barriers to Sustainable Urban Transport in Pakistan*  
Muhammad Imran  
Oxford University Press - 2010

The book aims to investigate institutional barriers particularly in the context of urban transport in Pakistan. It identifies and examines institutional barriers that create a hindrance to sustainable development, and thereby prevent the application and implementation of sustainable urban transport policies in Pakistan. The author aims to present a new perspective by investigating the relationship between international institutions, sources of finance and local problems. The goal is to highlight how these relationships should work, and how they are actually working in reality.

Throughout the book, the sustainability of urban transport appears as a major challenge to the institutions of modern society. Given the challenge, the author analyzes policies and institutions dealing with the problem of urban transport in Lahore. It raises questions about the international as well as national and local institutions' performance on the sustainability of urban transport. Finally it has identified the kinds of barriers that will have to be overcome in order for the new policy paradigm of sustainable urban transport to take root in Pakistan.

The analysis in the book has shown that sustainable transport cannot be achieved without addressing the institutional barriers. The analysis employed the concept of 'path dependence' to address the institutional dimensions and barriers in Pakistan.

The concept of path dependence was divided into three fields:

- The institutions field: to explore how institutional relationships, power and finance influence local and international institutions.
- The techniques field: to explore which method was employed for analysing transport problems and generating transport solutions.

- The discourse field: to explore transport problems as defined in the minds of local and international decision-makers.

In summary, this book makes three main conclusions:

1. Institutional path dependence was found in the local institutions for the development of sustainable transport planning in Pakistan.
2. The analysis highlighted the significance of techniques and methods for maintaining the stability of the road development paradigm in Pakistan.
3. Finally, the analysis shows the importance of discourse in long term stability of the road development paradigm in Pakistan.

*Gender Equality and Women's Empowerment in Pakistan*  
Rashida Patel  
Oxford University Press - 2010

In Pakistan women suffer all kinds of violence, whether it is domestic violence meted out to women within the family or home, honor killing, the practice of *vani* and *swara*, that is handing over girls to rival parties for settling disputes, being burnt, trafficking, rape, public abuse, sexual harassment, and the list goes on. Women are vulnerable because the laws are inadequate. Even though there have been some amendments in the laws, implementation continues to remain poor. The law enforcing agencies are biased; the patriarchal, male dominated environment makes women vulnerable to violence.

This book shows the deteriorating situation of women in Pakistan and the legal and other changes that have been introduced to improve their condition. Several references to laws which have an effect on women's lives, which have been amended have been added.

Women are not aware of their rights, whether it is in case of marriage, divorce, or reproductive rights. The low status accorded

to women in society, the general illiteracy, besides several customs and practices prevalent in Pakistan have a negative impact on the rights of women.

*Integrated Energy Sector  
Recovery Report & Plan  
October 2010  
Pakistan Energy Sector Task Force &  
Asian Development Bank*

Pakistan faces acute energy crisis. During the summer months there are prolonged outages in both urban and rural areas. Dependence on imported fuel has increased which has raised the cost of electricity generation and added to the country's balance of payments problems.

The Report reviews the recent performance of the energy sector, the key issues and challenges in the energy sector and the specific issues related to the performance in the power, gas and fuels sub-sector. It then offers solutions for Pakistan's energy sector. The recommendations have been formulated into a results focused implementation plan. The plan details specific reform actions and prioritized investment projects to be undertaken. The detailed implementation plan, alongwith the clear, easily monitored indications will help keep progress on track.

A lack of concerted focus on essential institutional and governance principles in the energy sector, insufficient maintenance, and stilted capacity expansion in recent years has resulted in the current crisis. Good plans were written to set the sector on a sustainable footing, but resources were never allocated to implement them, states the Report.

The energy sector suffers from institutional and structural fragmentation in the management of power, fuel, efficiency and regulation. There exists inefficient and below cost recovery structure; untargeted tariff subsidies; a stalled privatization programme which has reduced options for Pakistan to divest its energy sector assets and the lack of energy finance capability is a major contributor

to the lack of domestic energy infrastructure in the country.

Recommendations have been made which can be categorised into two main categories: energy reforms and energy investments. An implementation plan has been outlined. The plan includes both reform actions and measures to be undertaken by the government and stakeholders in Pakistan's energy sector.

*Drivers of Growth and  
Competitiveness in Pakistan 2010  
Competitiveness Support Fund*

The Report seeks to identify the key drivers of Pakistan's economic growth and competitiveness, with the objective to bolster its economic growth in a sustainable manner and enhance its competitiveness. It presents the principal challenges to both growth and competitiveness.

Pakistan's economic growth has slowed in recent years, and has not kept pace with neighbours like China and India. As a result, the country's prosperity, quality of life, level of poverty has been affected. It has become dependent on foreign transfers and remittances from workers abroad.

To achieve sustainable economic growth, the agriculture, manufacturing and service sectors must be competitive. The important drivers of growth have been identified as education and training of people, exports, investment led growth, foreign transfers invested in human and physical capital, improvements in the institutional environment for business.

Chapter 4 examines measures to address the most important challenges to Pakistan's competitiveness, while the last chapter of the Report shows the way forward and presents the Action Plan with responsibilities for key players. The action plan describes specific actions needed in ten strategic areas. It also describes the likely impact and identifies key partners.

## Pakistan Economy – Key Economic Indicators

	Unit	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10 <sup>P</sup>
<b>Output and Prices</b>								
GNP Size (MP)	Rs.bn	5765	6634	7773	8831	10452	13084	15239
GDP Size (FC)	Rs.bn	5250	6123	7158	8235	9921	12082	13843
Income Per Capita	\$	669	733	836	921	1038	1018	1095
<b>Real Growth</b>								
	(%)							
GNP		6.4	8.7	5.6	6.7	3.7	1.7	5.5
GDP		7.5	9.0	5.8	6.8	3.7	1.2	4.1
Agriculture		2.4	6.5	6.3	4.1	1.0	4.0	2.0
Manufacturing		14.0	15.5	8.7	8.3	4.8	-3.7	5.2
Services Sector		5.8	8.5	6.5	7.0	6.0	1.6	4.6
<b>Prices</b>								
	(%)							
Consumer Price Inflation		4.6	9.3	7.9	7.8	12.0	20.8	11.7
Wholesale Price Inflation		7.9	6.8	10.1	6.9	16.4	18.2	12.6
Food Inflation CPI		6.0	12.5	6.9	10.3	17.6	23.7	12.5
Non Food Inflation CPI		3.6	7.1	8.6	6.0	7.9	18.4	11.1
Core Inflation <sup>†</sup>		3.8	7.2	7.5	5.9	8.4	18.1	10.5
GDP Deflator		7.7	7.0	10.5	7.7	16.2	20.3	10.1
Gold Tezabi (Karachi)	Rs./10 grams	7328	8216	10317	12619	16695	22195	33544
Petrol Super	Rs/Ltr	33.69	40.74	55.21	56.00	57.83	67.68	67.56
Diesel	Rs/Ltr	-	-	36.45	38.40	40.97	60.42	69.57
Kerosene oil	Rs/Ltr	24.95	29.11	36.19	39.09	43.44	66.79	72.65
Wheat Flour	Rs/Kg	11.71	13.28	13.06	13.64	18.07	25.64	28.77
<b>Savings and Investment</b>								
	% GDP							
National Savings		17.9	17.5	17.7	17.4	13.4	13.2	13.8
Domestic Savings		15.7	15.4	15.7	15.6	11.4	10.5	9.9
Gross Fixed Investment		15.0	17.5	20.5	20.9	20.5	17.4	15.0
Public		4.0	4.3	4.8	5.5	5.4	4.6	4.3
Private		10.9	13.1	15.7	15.4	15.0	12.7	10.7
<b>Public Finance</b>								
Revenue Receipts (Fed Govt)	% GDP	13.5	13.5	13.5	14.0	13.7	13.2	14.0
Tax Revenue	% GDP	9.0	9.1	9.3	9.7	9.9	9.8	10.1
Total Expenditure	% GDP	15.9	15.4	15.8	15.7	18.8	16.5	17.6
Fiscal Deficit	% GDP	2.3	3.3	4.3	4.4	7.6	5.3	6.3
FBR Tax Collection (Fed Govt)	Rs.bn	510.0	590.0	704.0	839.6	1009.4	1251.5	1483.0
Direct Taxes	% share	31.7	31.0	32.0	38.2	38.4	39.6	36.4
Indirect Taxes	% share	68.3	69.0	68.0	61.8	61.6	60.4	63.6
Internal Debt Outstanding	Rs.bn	1979	2152	2337	2610	3275	3861	4653
Funded Debt	% Internal Debt	54.6	59.5	62.3	64.0	68.8	67.1	68.6
Un-Funded Debt	% Internal Debt	45.4	40.5	37.7	36.0	31.2	32.9	31.3
<b>Monetary Sector</b>								
Growth of Monetary Assets M2	%	19.6	19.1	15.1	19.3	15.3	9.6	12.5
Currency in Circulation	Rs.bn	578.1	665.9	740.4	840.2	982.3	1152.2	1295.4

P Provisional

<sup>†</sup>non-food non-energy

	Unit	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10 <sup>P</sup>
Credit to Private Sector	Rs.bn	1274	1712	2114	2480	2890	2907	3020
Credit to Public Sector	Rs.bn	657	747	834	927	1510	2034	2441
Borrowings for Budgetary Support	Rs.bn	575	641	708	810	1365	1681	2011
Resident Foreign Currency Deposits	Rs.bn	146	180	196	207	263	280	330
M2/GDP	%	-	-	0.45	0.47	0.46	0.40	0.39
<b>Capital Market (KSE)</b>								
Listed Capital	Rs.bn	377	439	496	631	706	782	910
Market Capitalisation	\$ bn	1422	2068	2801	4019	3778	2121	2732
Listed Companies at KSE	Nos	666	659	658	658	652	651	651
<b>Banking Sector</b>								
Scheduled Banks Deposits	Rs.bn	-	2428	2817	3373	3812	4138	4353*
Scheduled Banks Advances	Rs.bn	-	1694	2071	2376	2816	3080	3192*
Non-Performing Loans All Banks	Rs.bn	200	177	173	214	314	432	460
Lending and Deposit Rates	weighted average							
Deposits	% pa	0.95	1.37	1.96	2.60	4.13	4.44	4.29*
Advances	% pa	7.28	8.81	10.61	11.55	12.49	14.25	13.18*
<b>Open Market Operation</b>								
SBP 3-Day Repo	% pa	7.50	9.00	9.00	9.50	12.00	14.00	12.50
Treasury Bills Yield - 6 Months	% pa	2.08	7.96	8.49	8.90	11.47	12.00	12.33
KIBOR - 6 Months	% pa	2.69	8.46	9.36	9.75	13.95	12.65	12.25
Pakistan Investment Bonds - 5 yrs	% pa	5.27	7.50	9.65	9.53	-	12.40	12.60
Interbank Call Rates	%	2.70	6.10	8.80	8.90	9.90	13.20	12.20
SBP Export Finance Rate	%	1.50	6.50	7.50	6.50	6.50	6.50	8.00
<b>External Sector</b>								
Exports	\$ bn	12.31	14.40	16.45	16.98	19.05	17.68	19.35
Imports	\$ bn	15.59	20.60	28.58	30.54	39.96	34.82	34.71
Balance of Trade	\$ bn	-3.28	-6.20	-12.13	-13.56	-20.90	-17.14	-12.24
Current Account Balance	\$ bn	1.31	-1.75	-5.65	-7.40	-14.30	-9.40	-2.90
Workers' Remittances	\$ mn	3872	4168	4600	5494	6451	7811	8906
Foreign Private Investment	\$ mn	922	1677	3872	6960	5429	3209	2794
Direct	\$ mn	950	1525	3521	5140	5410	3720	2206
Portfolio	\$ mn	-28	153	351	1820	19	-511	588
<b>Debts</b>								
External Debt and Liabilities	\$ bn	35.3	35.4	37.2	40.3	46.2	52.3	55.6
Domestic Debt Outstanding	Rs.bn	2027	2178	2337	2610	3275	3860	4653
Internal Debt as % of GDP	%	35.9	33.5	30.7	30.1	32.0	30.3	31.7
National Saving Schemes**	Rs.bn	984	940	936	1004	1094	1361	1586
Total Reserves	\$ mn	13155	13338	14354	18890	13436	13971	17921
Gold	\$ mn	831	917	1268	1344	1926	1935	2575
Liquid Fx Reserves	\$ mn	12324	12421	13086	17546	11510	12036	15346
Exchange Rate (Average for year)	Rs/US\$	57.5745	59.3576	59.8566	60.6342	62.5465	78.4983	83.8017

\* December 2009 \*\* Outstanding

Source: Annual Report 2009-10, State Bank of Pakistan