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Special Supplement

SIRAJUDDIN AZIZ
an accolade to a leader

IBP

بسم الله الرحمن الرحيم

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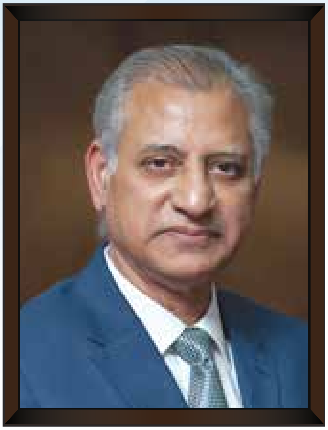
Foreword



Established in 1951, The Institute of Bankers Pakistan (IBP) holds a firm position amongst the banking and financial fraternity for being the knowledge hub formed to serve the industry with quality human resource at all levels. The Institute is well recognized both locally and globally for imparting trainings, certifications, professional qualifications and recruitment & assessment services.

IBP did not win this covetous position overnight. It is due to the fact that it has actively been engaged in research & development and knowledge-sharing for the development of human resources with modern learning processes and techniques. The results are there for all of us to observe as we see bankers with sound academic background, having more adaptability and ability to perform on multiple fronts.

I am glad that IBP's legacy of keeping its readership informed has not only enriched readers' knowledge but also motivates them to participate and explore. Of course, this is only possible with the support and appropriate guidance of a sound leader who is distinguished by the unwearied resolve and efforts which are essential to significant achievements. Fortunately, we have Mr. Sirajuddin Aziz in our team as Chairman Editorial Board since 2008.

Most of his editorial writings have provided impetus for change. His zeal for innovation is evident from one of his editorials wherein he stated "sustainable growth rarely generates out of a conservative maintain-the-status quo strategy, significant advancement calls for us to exit our comfort zones, try something new, even fail sometimes and learn from our lessons, but keep moving forward. There is always room for improvement and therefore, innovation. Bankers better keep their seat belts on, because there are still many phases of innovation to steer ourselves through."

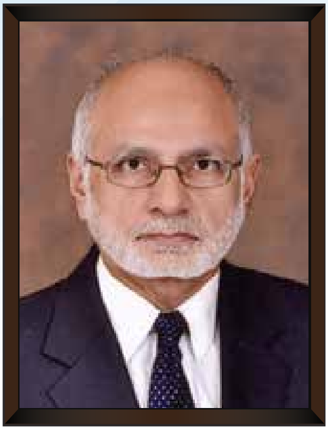
While Mr. Aziz's editorials are well known in the banking and finance fraternity, his intellectual contributions are not limited to these. He is a regular contributor to local and international dailies, journals and magazines. Besides all he has also authored books "The Quest of Mirage", "Saurab Ki Talaash Main", "Bitter & Sweet' and "The Essence of Islam". The varied topics of these books reflect the diversity of his interest and observations.

In acknowledgement of his voluntary services with utmost dedication and commitment over the past few years, the Institute has prepared this compilation of his editorials for the Quarterly Journal of IBP. I am confident that the readers will find this as a valuable source for reviewing developments over the years.

On behalf of The Institute of Bankers Pakistan, I am thankful for his time and I wish him good luck in his future endeavors.

Ashraf Mahmood Wathra
President - IBP

From the Desk of CE



I feel privileged to be the Chief Executive of this 6 decades' old knowledge hub functioning under the auspicious leadership of the Honorable Governor State Bank of Pakistan. We at The Institute of Bankers Pakistan are committed to train and develop productive human resource for the banking and financial fraternity with utmost dedication.

IBP has penetrated in various core areas of human development by offering multiple trainings, recruitment and assessment services to optimize the professional and personal growth of the bankers progressively.

In line with our ideology of serving the banking and financial sector of Pakistan with profound product offerings and knowledge sharing solutions; IBP has come up with several publications adding value to the learning horizons by capturing the interest and need of the bankers at all levels.

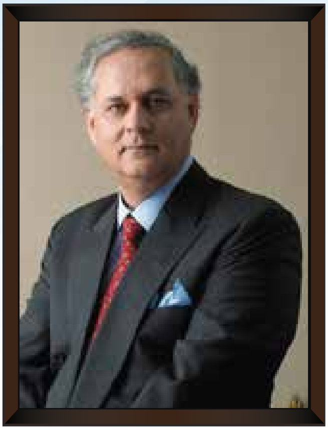
In today's world, when people are more keen on using internet rather than referring to books for reading or have low interest in writing; publishing quality content and urging the people to write is a challenge. I believe people like Mr. Sirajuddin are a ray of hope to keep the candle burning.

He has been associated with the Institute for almost a decade now guiding our Publications department as Chairman Editorial Board. Under his motivational leadership IBP has successfully produced several publications including regular publication of quarterly Journals by the name of BANKERS and Weekly Economic Letters, etc.

I take pride in presenting the book on Mr. Sirajuddin Aziz - *an accolade to a leader* as tribute to record our appreciation for his support guidance he has rendered during the last one decade.

Hussain Lawai
Chief Executive - IBP

Introduction



Sirajuddin Aziz is a professionally qualified and experienced banker who has worked for different organizations in Pakistan, China, Hong Kong, U.K, Nigeria and U.A.E.

He is currently the President & Chief Executive Officer at HabibMetro Bank. Prior to this, he has served as the Chief Executive Officer of a leading commercial bank in Pakistan from 2007 -2011. By virtue of being a senior member of banks' Management Teams/Committees, he has been actively involved in overseeing the entire spectrum of banking operations of various banks for over 20 years.

Mr. Aziz is a Fellow of Institute of Bankers Pakistan and a Member of Pakistan Institute of International Affairs. He is a regular speaker at the Institute of Bankers Pakistan (IBP) and other prestigious education institutes and universities, where he speaks on a diverse range of subjects comprising Credit, Trade & Foreign Exchange, Code of Governance, Economy, professional etiquettes and personal development sessions. He also participates in televised discussions on finance & economy and speaks at professional forums on banking related subjects.

Mr. Aziz is a regular contributor to national and international dailies, journals and magazines. He is a an author, with published works comprising 'The Quest of Mirage', 'Saurab Ki Talaash Main', 'Bitter & Sweet' and 'The Essence of Islam'.

Sirajuddin Aziz
Chairman Editorial Board - IBP

Golden Memories

Interview

It is said that in order to succeed in life, one has to go through a lot if hardships. So did you ever have to go through any such circumstances in your early career days?

It would not be realistic to expect any person to gain or achieve anything in life without an effort or a cost. This 'cost' may not always have a monetary value attached to it; it may also refer to an opportunity cost or time invested in pursuit of the subject goal/target/dream. So yes, it is true there is much pain behind every gain. I have had my share of setbacks, challenges and struggles during my career, and continue to experience some every now and then. I believe that while positive outcomes are a blessing, unfavorable outcomes are opportunities to become better. Hence, I attempt to take setbacks in stride and continue working with unflinching faith – while keeping my head down and chin up!

Being a senior professional and a busy person, how do you create a work-life balance?

Through most of my working life, I have attempted to attain this fine balance that has been bestowed with the very legitimate-sounding jargon 'work-life balance'. After a career spanning over three decades, I can only come to the conclusion that this state of balance is, to a large extent, an illusion. After reaching home from work at 8-9 pm, I rarely have the energy to pursue this illusion and just settle with having dinner and some conversation with my family. Till now, my family has not complained about any inattention or lack of interest from my side, so presumably I am faring well in this regard.

Moreover, I do try to take some time out for reading, writing and listening to music – these interests serve to rejuvenate my mind.

To be a professional banker what qualities do you think an individual should acquire or possess?

Banking is a demanding field. To make a career in the financial industry, an individual should ideally possess characteristics such as charisma, integrity, dedication and perseverance, along with an aptitude for the job. Nowadays, bankers do not find it sufficient to be only financially-savvy; they also require a certain proficiency in technology, people-management, sales management and marketing. Expertise in these realms complements their core banking knowledge and awareness of regulatory requirements.

A good banker, in my view, manifests the trait of empathy – and this sentiment extends beyond clients; in fact, it is extended to the entire populace.

How do you see the potential of Pakistani bankers in comparison to the rest of the world?

Pakistan has some of the best talent reserves in various fields/occupations. You can find Pakistanis faring well in all leading financial markets around the world. We should further hone our nation's talent through specialized higher education. We must, in fact, encourage the export of professionals.

What guidance would you like to give to the upcoming youth interested to make a career in the financial sector of Pakistan?

To youth in general, I always say 'read, read, read and never stop learning'. Continuous improvement is a philosophy and habit that we must inculcate in the youth. It is the best mindset that we can pass on to them.

For youth who are interested in pursuing a career in banking, my advice is 'Obtain a very sound understanding of banking fundamentals at the start of your career.' This is generally not taught in much depth at an undergraduate degree level, so the options of such trainings available to young graduates are specialized courses, e-learning and self-learning through books on banking. They can also join Management Trainee programs of banks which provide comprehensive on-the-job and conceptual training before allocating talent to appropriate job placements.

You have been associated to the editorial board of IBP as a Chairman for almost a decade now. How would you define the power of pen?

I have been writing articles for publications for longer than I have been working (in fact I penned my first article as a teenager), and the only thing that motivates me to regularly take out time for this activity is that its benefits transcend the effort that goes into it manifold. Not only is writing (whether it be on banking, international relations, public policy, foreign policy, social issues, organizational behavior or management) a cathartic process, it is also a productive way to give back to the society. I feel that it is beneficial for us to write about our areas of expertise, general knowledge and specific experiences so that readers at large can learn vicariously through our lives, our achievements and our mistakes.

Reading and writing were habits that my father inculcated in me during childhood; he himself was a voracious reader and an infrequent writer.

Would you like to share any suggestions for IBP Publications?

The IBP is doing a remarkable job with its contribution to the progress of Pakistan's financial sector. It delivers as a knowledge center that ensures the development of the industry and its human resource body.

The Publications team, too, is doing commendable work. My only suggestions are to keep up the good job and to focus on research-based writing contributions that cover a wider spectrum of banking-related subjects.

The IBP should aspire to enhance the quality of its publications to such a level where an article appearing in their journal will be cited onward as a credible source on the topic/subject.

Improving operational efficiency has to be high on the agenda of bankers considering the highly regulated and rapidly transforming business landscape. What in your opinion should be the role of IBP as a professional body of bankers?

The standard of academics at the IBP is quite impressive, as is testified by its prestigious international affiliations. An effective way to target the enhancement of the impact that operational efficiency-related courses and programs offered at the IBP have, is to benchmark the details of such programs against those offered by other leading institutions like the IBP around the world. It would also be beneficial to do a thorough gap analysis in collaboration with the banking industry to improve upon course contents in such a manner that they achieve targeted results.

Also of interest would be a baseline study that outlines the difference between the operational efficiency exhibited by the Pakistani banking industry and that of leading financial centers around the world. Benchmarking through this exercise will provide the IBP with insights about what the local sector needs to be at par with, and subsequently exceed, the most advanced financial industries in the world.

Challenges and Opportunities go hand in hand. What in your opinion are the opportunities for IBP in the ongoing challenging environment? What should IBP do to capitalize those opportunities?

For a professional institute with an academic agenda, challenges prevalent in the subject industry should be opportunities in disguise as this presents areas/segments/issues on which professionals require higher standards or requisites of training.

The IBP already invites participation by bankers; in order to further utilize this participation for designing training frameworks that target professional abilities to overcome existing set of challenges, the Institute needs to engage bankers regularly to outline what challenges they face or foresee. Another important aspect is that, in doing so, the IBP should invite feedback/input from line managers or second-tier management who can provide more specific and detailed knowledge of issues that they face.

Besides many articles in newspapers and journals you have authored several books like Quest of Mirage, Bitter and Sweet (Life & Times of Dad) and the Essence of Islam. The "In Quest of Mirage" is your poetic work. What was the underlying idea in bringing out this poetic work?

The "In Quest of Mirage" is a compilation of poetry that I penned down over the course of many years, sometimes on small pieces of paper, napkins and airplane boarding cards. This, I later got translated into Urdu and the translated compilation was published as 'Sohraab Ki Talaash Mai'.

Poetry (and my interest in the same) is the underlying passion behind the work; I did not write any of the poetry in the compilation with the intention of publishing it. At the time when I was penning down the individual pieces, I was just transcribing my thoughts in ink.

The architecture of In Quest of Mirage is not defined by parameters of a consistent time period. My poetry has evolved with me as a person over time in different spheres of my journeys and experiences in life, complemented by lessons learnt and observed during the passage. The verses are a testimony to my views reflected upon during various official trips abroad, stays in hotel rooms, long arduous flights and insomnia!

It was a private effort and one that I did for my eyes only. It was only later that upon the suggestion of friends I started toying with the idea of compiling the poetry. Initially, I was hesitant to publish the pieces of work that contained private thoughts and feelings, but the requests were persistent and eventually I was brave enough to do so!

It is one thing to transcribe one's life's events; it is another to ink one's soul onto paper. Doing the latter was an attempt of this collection of poetry; contributing in some way to bringing a smile, fuelling aspirations, giving hope or offering strength to the reader is its purpose.

SBP's Second Quarterly Report 2007 – 08

The recently released second quarterly report of the State Bank of Pakistan presents a perceptive analytic assessment of current trends in the economy and highlights the challenges confronting it. It recommends appropriate policies and measures for ensuring socially necessary growth in an in-hospitable international economic milieu.

The report quite rightly warns about the heightened threat of macro-economic complications after five years of commendable growth if prompt steps are not taken to correct the recent deterioration in fiscal and external current account indicators. It has highlighted the challenges stemming from a persistent climb in prices.

According to the report, the country's economy continues to be resilient to domestic and international shocks. The growth in gross domestic product (GDP) in FY 2008, despite domestic turbulence and external shocks is expected to be in the range of 6.0 – 6.5 percent as against the target of 7.2 percent. This below target growth is nonetheless quite impressive.

So far as performance in the agriculture sector is concerned, the prospects of achieving the targeted growth of 4.8 per cent despite record sugarcane and maize harvests and above target increase in minor corps, are quite dim. The disappointing performance of some major kharif crops is primarily responsible for below target output of this crucial sector of the economy. Value addition in agriculture can be enhanced by investment in farm-to-market roads, agri-storage facilities and small processing units.

There was a welcome growth in institutional credit disbursements to agri-sector by Rs. 23.8 billion to Rs. 104.8 billion during July – January FY 08. This is attributable to aggressive lending by commercial banks in response to strong demand on account of rising prices of fertilizers, pesticides, energy, labour charges and transportation. Large increase in commercial banks lending to agriculture compensated for a decline in lending by specialized banks during July-January FY08.

Despite commendable growth in agri-credit disbursements, small farmers access to institutional credit is limited which is unfortunate as small farmers account for 80 percent of land holdings. The main reason for this disappointing credit access of small farmers is the non-availability of financial infrastructure in rural areas and the poor performance in documentation of land titles.

In order to enhance the outreach of institutional credit to small farmers having no collateral, State Bank of Pakistan introduced "Financing Scheme for Small Farmers (FSSF)". This scheme seeks to resolve the root of market failure in agriculture credit i.e non-availability of collateral. The FSSF is based on small groups of farmers and covers all areas of agriculture including farming, livestock, dairy, poultry, fisheries and horticulture. Banks will determine the eligibility for loans by on-site verification of farming activities being financed and assessment of cash flows of individual members.

In the important field of large scale manufacturing (LSM), July- December FY08 data indicates deceleration in growth to 4.8 percent as compared with 8.4 percent in the same period last year. Domestic as well as external factors are responsible for this lacklustre growth. These factors include: the continued strong increase in international commodity prices, domestic energy shortages and dampened demand for textile exports.

The slowdown in LSM during HI-FY 08 was broad based and was seen in 11 out of 15 groups. Of these, paper and board, metals, fertilizer and electronics industries recorded a decline in output. The textile sector also performed poorly mainly on account of sharp slowdown in its exports. The prospects for the LSM sector according to the report will largely depend upon the nature of the political scenario, law and order situation as well as the effectiveness of promotion policies.

The services sector which accounts for more than 50 percent of GDP and over a third of employment, showed commendable progress in the first half of FY08. The strong performance of this sector is attributable to acceleration in retail and wholesale trade, higher profitability of the financial sector and strong growth in the community services.

Inflationary pressures in the economy during the first eight months of FY08 remained uncomfortably strong primarily on account of high international commodity prices (food as well as energy) and strong domestic demand. The 12 months moving average of consumer price index (CPI) in February 2008 was 11.3% higher YoY as compared to 7% in June 2007. The contribution of food group to overall inflation increased from 55.4 % in February 2007 to 59.9 % in February 2008. Inflation as measured by Wholesale Price Index (WPI) was recorded at 16.4 % (YoY) in February 2008. WPI food inflation exhibited a sharper rise and was recorded at 18.3 % in February 2008 mainly on account of increase in the prices of food items like rice, maize, vegetable ghee, wheat, fresh milk and cooking oil.

The Sensitive Price Indicator (SPI) based on 53 essential items of daily use witnessed an increase of 12.3% (YoY) in February 2008 as compared to 8.8 % in February 2007. The weekly SPI showed an acceleration of 15.7 % in the second week of March 2008 as compared to 12.5 % in the last week of January 2008.

The importance of keeping inflation low cannot be over-emphasized. The de-stabilizing consequences of inflation for the external value of our rupee, worsening of income distribution in the country, distortion of incentives, encouragement of speculation, aggravation of corruption and breakdown of governance are well known.

It is generally insufficiently appreciated that many of our social, political and administrative problems have their roots in the persistent rise in prices.

History tells us that countries in a state of inflationary ecstasy are generally prey to administrative break-down, class conflict and disorder - the precursors of totalitarian governments.

The increase in broad monetary aggregate (M2) during July-1st March FY08 was 7.1% as compared with 8.7% during the same period in FY07. The SBP, however, projects that the growth of M2 in FY08 would be in the range of 15.5-17.5 % as against the target of 13.7 %. This has the potential to add to the excess demand pressures in the economy. To control monetary expansion it has raised its policy discount rate by 50 bps to 10.5 percent and the cash reserve requirement of the banking system by 100 bps on current deposits effective from 1st February 2008.

Government borrowings from the banking system during July- December FY08 amounted to Rs 228.6 billion the compared to Rs 31.5 billion in the first half of FY07. The government has been borrowing from SBP as well as commercial banks. The SBP, however, has been the major source of deficit financing as it provided Rs 200.6 billion, 153% more compared to HI-FY07. Commercial banks also provided Rs 31.8 billion during HI-FY08 for budgetary support to the government in contrast to net retirement of Rs 51 billion during H-I FY07. During July-1st March FY08 government borrowing for budgetary support from SBP increased to Rs 359.3 billion.

Private sector credit growth during July-1st March FY08 was 11.7% compared with 11.2% in the corresponding period of the previous year. The resilience in bank credit to private sector is attributable to a sharp rise in raw material prices both in the domestic and global markets. Besides banks, non-bank financial institutions are meeting the financing needs of the private sector through investment in debt instruments (TFCs and Sukuk). Availability of foreign investment and loans has also played a significant role in softening the demand for domestic private credit.

In the fiscal field, key performance indicators deteriorated significantly during HI-FY08 as revenue growth stagnated while expenditure continued to rise. Total revenue estimated at Rs 625.6 billion during HI-08 was only 1.8 % higher as compared with Rs 614.8 billion mobilized during HI-07. The lacklustre growth in revenue receipts stemmed from deceleration in tax revenues as well as an actual decline in non-tax receipts.

The deterioration in fiscal performance indicates that if current trends persist the annual fiscal target of 4% of GDP will not be met. The SBP has been urging the government to take necessary steps to achieve the fiscal deficit target as this would reflect the government's commitment to fiscal discipline and macro-economic stability.

The increase in fiscal deficit during HI-FY08 was accompanied by a sharp decline in external financing flows. This forced the government to enhance its reliance on domestic sources for budgetary financing.

During July-December FY08 the contribution of external resources (net) was only Rs 68 billion as compared with Rs 96.2 billion during corresponding period of the previous year.

There was a sharp rise in public expenditure during HI-FY08 due to significant increase both in current and development spending. The current expenditure during July-December amounted to Rs 775.1 billion as compared to Rs 581.4 billion during HI-FY07. This was mainly due to growth in interest payments and rise in spending under economic affairs. Development expenditure also increased sharply during H-I FY08 (48.2% YoY compared to 16.4% during July – December FY07). The federal government's share in development spending was 52.9% and 47.1% was for provinces during July – December FY08. Defence spending during July – December FY08 amounted to Rs 131.8 billion which constituted 1.3 % of projected GDP.

The overall domestic debt of the country, inclusive of permanent debt, floating debt and unfunded debt registered a growth of 10.6% during HI of the current fiscal year and amounted to Rs 2877.8 billion at the end of December 2007.

In the external sector of the economy, the cumulative July – January FY08 current account deficit rose by 46.1 % to $ 2.414 billion compared to 51.0% YoY increase in the same period last year. The principal factors responsible for deterioration in the external account are an abrupt rise in the country's oil bill, large one – off aircraft import, the impact of political disturbances in December 2007 as well as delays in the receipt of coalition support funds.

The adverse impact of the widening of current account in the country's over-all balance of payments was aggravated by a decline in the financial and capital account balance in the same period.

On account of worsening of external account during July-January FY08 Pak rupee depreciated by 3.5% during July-February, highest depreciation since HI-FY 05 and significantly larger than the meagre depreciation of 0.8% in the same period last year.

The report has correctly pointed out that correction in external balance lies either in export promotion or import compression, or a combination of the two. The policy options for import compression include imposition of tariff, tight monetary policy and exchange rate depreciation. The former option is exercisable in limited cases where MFN rates are significantly lower than those required under WTO regulation. As regards the other two options, the SBP has already tightened monetary policy to control aggregate demand and Pak rupee has depreciated against the US dollar in recent months.

It is heartening to note that workers' remittances during July-January FY08 rose by 22.4% to $ 3.62 billion against $ 2.96 billion in the same period last fiscal year.

According to data released by Federal Bureau of Statistics, export earnings during July-February FY08, recorded an increase of 7.86% to $ 11.70 billion as compared with $ 10.85 billion in the same period of last year. Import payments during the afore-mentioned periods amounted to $ 24.14 billion against $ 19.79 billion, a rise of 21.95%. The trade deficit thus increased to $ 12.43 billion against $ 8.94 billion in the same period last year. Earnings through export of the services sector in the first seven months of FY08 stood at $ 1.62 billion against $ 2.28 billion in the same period in FY07.

Total foreign investment inflow in the country inclusive of foreign direct investment and portfolio investment in the first seven months of FY08 stood at $2.26 billion as compared with $ 3.48 billion in the same period of the preceding fiscal year, a decline of about 35 %.

The country's external debt and liabilities amounted to $ 42.88 billion at end-December 2007 as against $ 40.48 billion at end-June 2007. This increase is due to rising imported oil prices and lower than anticipated privatization proceeds.

Total liquid foreign exchange reserves of the country stood at $ 14.06 billion in the week ending February 16, 2008, of which $ 11.8 billion were held by the SBP and the rest by the banks.

In conclusion, it may be stated that if effective policies are not adopted for positively responding to internal and external economic challenges highlighted in the report, it will not be possible for us to realize the cherished goal of accelerating growth on a self-reliance basis.

Selected Economic Indicators

Growth rate (percent)

		FY06	FY07	FY08
LSM	July-Dec	8.7	8.3	4.5
Exports (fob)	July-Feb	18.8	3.4	7.9
Imports (fob)	July-Feb	46.3	9.9	21.9
Tax revenue (FBR)	Jul-Jan	21.8	25.1	10.6
CPI (12 month MA)	Jul-Feb	8.9	7.7	8.4
Private sector credit	Jul-March	18.9	11.2	11.7
Money Supply (M2)	Jul-March	9.5	8.7	7.1

Billion US dollars

Total Liquid reserves	End-Feb	11.5	13.3	14.1
Home remittances	Jul-Jan	2.4	3.0	3.6
Net foreign investment	Jul-Jan	1.5	3.4	2.3

Percent of GDP

Fiscal deficit	Jul-Dec	1.8	1.9	3.6
Trade deficit	Jul-Feb	5.9	6.2	7.9
Current a/c deficit	Jul-Jan	2.7	3.6	4.8

Pakistan's Economy: Challenges Ahead

These are challenging times for the world economy where inflation, food crisis, spiraling oil costs, exchange rates stability are looming large on the horizon. They have engulfed Pakistan's economy though in variable proportions. Our country risk rating has been the victim of international credit rating agencies. Each institution is trying to fight the demons of the lethal combination of economic and political uncertainty. It is a cause of concern for the policy makers.

It is alarming that our FDI has decreased by 14 % in the last eleven months for the period July-May 2007-08 to US $3.8 billion from US$ 4.5 billion in the corresponding period last year. The foreign exchange reserves also exhibit a discouraging state of affairs in comparison to a time when we proudly gloated over the figure of US $16 billion which has plummeted to an abysmally low figure of around 10.95 billion US$. Inflation has been swallowing our economy incessantly like a morbid disease and the remains have been getting dissolved in the quick sand of mounting debt.

Similarly, skyrocketing oil and commodity prices in the international market and supply shortages of essential commodities are playing a vital role in deteriorating the state of the economy. Several macroeconomic indicators missed their targets by significant margins. The gaping discrepancy is marked by the shortfall of average GDP growth recorded at 5.8%, comparatively lower against the target of 7.2%. The impetus in this year's growth came mainly from the services sector which posted a growth of 8.2% as against 7.6% last year.

Other areas of concern include the widening current account and trade deficits which have worsened significantly. Trade deficit for 10 months of FY08 was recorded at US$ 17 billion as compared to US$ 11 billion in the corresponding period last year, owing primarily to a 28.3 % increase in imports as against exports which grew by a feeble 10.2 %. Pakistan's current account deficit was recorded at US$ 11.6 billion during the first 10 months of FY08 as against US$ 6.6 billion during the same period of FY07 signifying an increase of 75%. Overall inflation for the first 10 months was 10.3 % against the target of 6.5 % mainly due to food inflation at 15% against 10.2% in the same period of FY07 and also due to non food inflation at 6.8% against 6.2% respectively.

Amidst this obvious mayhem the SBP announced policy directives to streamline the macroeconomic fundamentals. These steps have been taken to rescue the economy from the dwindling macroeconomic situation. State Bank announced an interim Monetary Policy, the salient features of which were:

- Increase in discount rate by 1.5% raising to 12%
- Increase in cash reserve requirement and Statutory liquidity requirements by 1% from 8% and 18% to 9% and 19% respectively.
- Minimum return of 5% to be paid on all Profit & Loss Saving accounts by Banks and Financial Institutions
- Imposition of a margin of 35% on LC with an exception of some edible items and Oil imports.

The primary purpose of the above strategy has been to tame inflation which has risen to alarming proportions and to also discourage government borrowing which is causing a persistent dent in the fiscal budget of the economy. The measures have been taken in consultation with the government authorities and in alignment with SBP's objectives.

The above tools would first and foremost operate to drain out any semblance of excess liquidity from the market. Financial institutions and banks which were replete with liquid funds have themselves strapped of excess cash or near cash resources especially after an increase of overnight call rates to 20% - 25%. The increase of CRR and SLR would lead to an increase in the proportions of banks' reserve deposits with the SBP. This effort is reinforced by the increase in discount rate from 10.5% to a considerable 12% which will not only discourage government from borrowing from the SBP but will also result in expensive call and money market rates.

Consequently, the restrictive pressure on the banking spreads would make borrowing for every lender a difficult and a costly initiative. The lender market will be dampened. However, Banks will be more prudent in advancing credit facilities to clients as it is hoped that quality will replace the quantity phenomenon. The ADR of majority of financial institutions will take a dive towards more measured lending practices as the cost of funds will take a spiraling hike. The mandatory requirement for payment of minimum return of 5% per annum on all categories of savings/PLS saving deposits, including any other profit bearing deposit with no fixed maturity – this rate being applied to all existing accounts – will significantly consume the profit margins of those financial institutions which have a large chunk of low cost deposits in their portfolios.

On the off balance sheet side, the Central Bank in consultation with the Government will look into the demands of the industry for exempting essential industrial raw materials from mandatory 35% cash margin requirement on opening letters of credit (LCs) to facilitate the local industry.

Holding 35% margin for LCs will seriously affect the liquidity of entrepreneurs as either they will have to borrow additional working capital at high mark ups or their working capital will be siphoned out. In either case the liquidity of the companies will be affected leading to further increase in financial burden. It would increase the manufacturing cost of production and make Pakistan uncompetitive in the international market resulting into an adverse effect on exports of the country. Taking cognizance of the fall out of margins on LC, the SBP has issues a list of items that have been exempted from this requirement.

Banking circles have expressed concern on draining out of Rs 90 billion from the banking system as a sequel to this announcement by SBP. 1% increase in the discount rate would increase minimum 2% KIBOR rate in the market, further increasing the financial cost/burden of the companies due to which the economic activity and industrial growth have already shrunk. This is evident by the present industrial growth which reduced to 8% last year compared to 18% three years ago and further to less than 4% this year.

The SBP Governor explained in detail the rationale behind the interim monetary policy measures and said that the 150 basis points increase in the discount rate had been necessitated by the persistent and excessive government borrowing from the SBP to meet the financing requirement of the budget deficit. The stock of government borrowing from SBP is more than double of last year's level and, in order to offload this huge debt to the scheduled banks, this rate hike will act as a critical measure to induce the scheduled banks to participate actively in T-bill auctions.

In addition to the above, the federal budget for 2008—09 envisages the total outlay of Rs 2.01 trillion. Some of its key features are:

¤ GDP growth is projected at 5.5% with inflation containment at 12% and fiscal deficit as a proportion of GDP at 4.7% and current account deficit at 6% GDP.

¤ Gross revenue is projected at Rs 1.68 trn

¤ Net revenue receipts are projected at Rs 1.25 trn inclusive of an increase of 1% on general sales tax from 15% to 16%. PSDP is placed at rs 550 bn

¤ The level of minimum wages has been raised from Rs 4600 to Rs 6000 per month

- Profit level on NSS has been raised by 2%

- Tariff rates on 300 non-essential items have been raised

The budget is expected to have a neutral to negative impact on the banking sector. Especially, the rapidly deteriorating economic variables and recent policy measures announced by the SBP are likely to have an adverse impact on the banking sector in the long run. Higher lending rates are likely to result in moderate lag credit off-take and a slowdown in the general lending activity. Moreover, amidst inflationary pressures operational expenses are on the rise which would impact the sector's net earnings.

Against this backdrop, bottom line growth is expected to slowdown and the banking sector ROE is likely to decline to 20% in FY08 as compared to 25% earlier. Despite the short term dampening effect on the overall economy, it is hoped that the strategies of the SBP would augur well for the entire economy in the long run, whose benefits would trickle down to the business generating avenues of the country, eventually.

Last Quarter FY08

The world economy is facing crisis of a challenging nature. The US and European markets are embroiled in turmoil which is pushing their economies into a quagmire of deep recession. Such a trend has a contagion effect on not only the western markets but the same can be seen spreading to Middle East and gradually to the East Asian economies.

Contrary to people's expectation, Global crises which emanated from the Sub Prime Mortgage crises in the US, has not impacted Pakistan in any visible manner. However, the market has been fraught with all sorts of rumors regarding the turmoil in the banking sector. Such news only created unrest in the market. Subsequently, this market anxiety was well countered by strategic and timely measures adopted by SBP.

The impetus to the escalating apprehension was primarily the outflow of funds from the banking sector post Ramadan. The circulation of cash increased manifold and the same was not reinjected into the banking system. Consequently, it put a liquidity rather strain on banks, which was aggravated by uncalled for rumor mongering relating to banking industry.

A study of the macroeconomic fundamentals clearly indicate that Pakistan's economy is not well integrated with the world markets. Therefore, the effect on our economy of the ongoing crises is negligible. Our economy is well insulated from external shocks specifically pertaining to the mortgage portfolio; we have been saved from the menace of globalization. However, the financial complexities plaguing the economic landscape of the country are purely domestic in nature.

Pakistan is experiencing economic turbulence which has been a result of unhealthy macroeconomic fundamentals. Pakistan is the 25th largest economy of the world. It has suffered from internal political instabilities, a growing population, varying and unstable inflows of foreign investment, rising costs of production, hiked up inflation levels, riding fiscal and trade deficits and falling foreign exchange reserves.

The year 2008 has been punctuated with many apprehensive developments. The unstable political situation of the economy has led to a decline in FDI from approximately US$ 8 billion to US$ 3.5 bn for the current fiscal year. Consequently, there was massive capital flight from Pakistan to the Gulf. Combined with high global commodity prices, the dual impact has shocked Pakistan's economy, with gaping trade deficits, headline inflation running above 25% and a crash in the value of the Rupee, which has declined by almost 23% in this year alone.

The major stimulus for this has been rising oil prices, costly food and agricultural imports, falling exports and increased government borrowing from central bank. The current fiscal deficit of Pakistan is at 7.4% of the GDP which is targeted to be brought down to 3.4% in the coming fiscal year. Official statistics reveal that during July-August FY09 the country faced a current account deficit of US$ 2.572 billion dollars against US$ 1.571 billion during the corresponding period last year. The rising trend of current account deficit would put a further negative impact on Pak rupee. The government will be compelled to get more foreign loans to support the dwindling foreign exchange reserves, which amount to US$ 6.737 billion out of which only US$ 3.497 billion are held with SBP. These reserves are not enough to pay our rising import bill on an ongoing basis.

Consequently, Standard & Poor's cut its ratings on the nation's sovereign debt deeper into junk bond territory, eight rungs below investment grade. S&P lowered Pakistan's foreign currency debt rating to CCC plus from B, just several notches above the default level. Pakistan's local currency debt rating was lowered to B minus from BB minus. Credit agency Moody's Investors Service cut its outlook on Pakistan's debt to negative from stable due to political uncertainty, though it maintained the country's rating at B2. The cost of protection against a default in Pakistan's sovereign debt trades at 1,800 basis points, according to its five-year credit default swap, a level that indicates investors' nervousness.

The price of oil has declined by 50% now, to almost US$ 55 per barrel. This has put a strain on the Middle Eastern economies and on their spending and investment plans in Pakistan. It is now hoped that due to fall in commodity prices throughout, the import bill of Pakistan shall be curbed. Although our exports revenue will register a decline as US has been our main market of exports. Our remittances inflow is likely to record a dip as the recession in the US economy is leading to massive layoffs of workers and majority of our remittance flows are from USA and GCC countries.

Despite such a dismal scenario, our Central Bank is committed to supporting the entire financial industry to provide comfort to the market at the end of the day. SBP has devised various policy measures to curb inflationary pressure, add to the depletion of international reserves, strengthen bank's liquidity portfolio by injecting funds to release the credit crunch and set up customer service centers throughout to assist bank customers.

In the wake of the liquidity crunch, the SBP has reduced the Cash Reserve Requirement for all deposits of up to one year maturity held by banks by 200 bps to be introduced in two tranches. The first reduction of 100 bps was made effective from October 11, 2008 while another reduction of 100 bps was made effective from November 15,2008. The 2% decline from 9% to 7% alone released a liquidity of about Rs 61 billion to be injected into the banking system. The SBP also injected US$ 100 million in the forex market of the country to stabilize the volatility in the local exchange market. The Governor SBP has categorically stated that the banking system is well poised to absorb markets shocks. The capital adequacy ratio of 12.1% as of June 2008 has been well above the internationally accepted minimum capital requirements.

The SBP has, as part of its interim monetary policy for the current fiscal year raised its discount rate by 200 bps from 13% to 15%. The Central bank issued a directive instructing banks to reduce their ADRs by March 2009 to 70%. Subsequently, it further relaxed the ADRs of banks in order to provide further liquidity in the money market. With the revised formula for calculating ADR, the industry ADR declined to 57%. SBP has encouraged banks to lend for commodity financing activities, power sector and interbank market. The revision of ADR lead to an injection of Rs 500 – 550 billion in the banking sector. The SBP has also decided to provide 100% financing to banks under Export refinance facility part II which was previously shared by banks up to a 30%.

SBP's initiatives shall facilitate achievement of the following:

¤ Stabilization of macro economic fundamentals and support of weakening Pak rupee value

¤ Contractionary monetary policy to curb inflation which is targeted to be controlled at 20% in the current fiscal year

¤ To redress the balance in the declining foreign exchange reserves

¤ To reduce fiscal deficit and government borrowing from the Central bank

¤ Improvement in the current account deficit going forward

¤ To add to consumer's confidence and to provide comfort to the banks operating in the industry

An economic growth of 4% is consistent with the expected developments in the fiscal, external, and monetary sectors and inflation outlook. While removing these bottlenecks is imperative in achieving sustainable economic growth, in the interim period, focus of macroeconomic policies should remain on curtailing domestic demand. On a conclusive note, the tight monetary policy is only one ingredient of the macroeconomic stabilization program. Several stabilization and structural adjustments in the fiscal, external, and financial sector are required immediately and are being implemented, in the medium term, to put the economy back on a stable path.

The crux of SBP's initiatives entail building the country's foreign exchange reserves, supported with appropriate exchange rate policy, and bringing the fiscal deficit to sustainable levels by rationalizing expenditures and strengthening tax revenue generation.

Challenges of Financial Industry – 2009

The global financial crisis, brewing for a while, really started to show its effects in the middle of 2007 and blasted into a full blown catastrophe in 2008. Around the world stock markets have fallen, large financial institutions have collapsed or been bought out, and governments in even the wealthiest nations have had to come up with rescue packages to bail out their financial systems.

The collapse of the US sub-prime mortgage market and the reversal of the housing boom in other industrialized economies have had a ripple effect around the world. Furthermore, other weaknesses in the global financial system have surfaced. Some financial products and instruments has become so complex and twisted that, as things started to unravel, trust in the whole system started to fail.

The rising defaults on sub-prime mortgages in the US triggered a global crisis for the world markets. Many of the world's leading investment banks have collapsed as a result and the US government has proposed a massive bail-out. The global crisis has become one of the most radical reshaping factors of the global banking sector, as governments and the private sector battle to shore up the financial system following the disappearance of some large global investment banking entities. As a result, the global banking industry is almost unrecognizable from what it looked like 12 months ago.

In Europe too, the landscape has changed. Germany's second largest mortgage lender, has been bailed out by the government. Japanese banks have remerged as a powerful force in international banking having steered clear of the worst excesses of the sub-prime crisis in the US, although it remains to be seen; since cultural issues impinge on immediate disclosure in the North East Asian countries.

For the developing world, the rise in food prices as well as the knock-on effects from the financial instability and uncertainty in industrialized nations are having a compounding effect. High fuel costs, soaring commodity prices together with fears of global recession are worrying many developing country analysts.

During periods of boom no one wanted to hear of caution and even thoughts of the kind of regulation that many are now advocating. To suggest anything would be free market mechanism or pro regulated market system. At such times governments attempt to stimulate the economy. Standard macroeconomic policy includes policies to increase borrowing, reduce interest rates, reduce taxes and spend on public works such as infrastructure.

Joseph Stiglitz argues that failures in financial markets have come about because of poorly designed incentive structures, inadequate competition, and inadequate transparency. Part of this is because larger institutions have been resistant to changes that would actually create more healthy competition, something Adam Smith has long noted in his Wealth of Nations, often regarded as the Bible of capitalism. Better regulation is required to reign in the financial markets and bring back trust in the system.

Having stated the turmoil that the entire global economy is engaged in, fortunately, Pakistan has been largely insulated from the harsh economic endemic. Consequently, Pakistani banking system has not been severely hit as such for reasons that the local banking industry does not have any tenacious links with the global banking industry, or exposure to toxic assets.

Our GDP, foreign investment, exports or trade as percentage to the GDP has been quite conservative compared to other countries because our low affiliation with the international financial world. Our consumer portfolio, although has boomed greatly in the last 4 to 5 years but nevertheless has not been stiffly aggressive as the markets in the developed world where lending was done rather irrationally.

Pakistan's banking sector is made up of 53 banks, which include thirty commercial banks, four specialized banks, six Islamic banks, seven development financial institutions and six micro-finance banks. According to the 2007-08 Financial Stability Review from the State Bank of Pakistan (SBP), 'Pakistan's banking sector has remained remarkably strong and resilient, despite facing pressures emanating from weakening macroeconomic environment since last 2007.' According to Fitch Ratings, 'the Pakistani banking system has, over the last 4 decades, gradually evolved from a weak state-owned system to a slightly healthier and active private sector driven system.

The data from the banking sector for the final quarter of 2008 confirms a slowdown after a multi-year growth pattern. In October 2008, total deposits fell from Rs. 3.77 trillion in September to Rs. 3.67 trillion. Provisions for losses over the same period went up from Rs.173 billion in September to Rs. 178.9 billion in October. At the same time, the SBP has jacked up interest rates: the 3-month Treasury bill auction saw a jump from 9.09% in January 2008 to 14% in January 2009, and bank lending rates are now as high as 20%.

Overall, Pakistan's banking sector has not been as prone to external shocks as have been banks in Europe. Liquidity is tight, certainly, but that has little to do with the global financial crisis and more to do with heavy government borrowing from the banking sector, and thus tight liquidity and the 'crowding out' of the private sector. The banking sector reforms introduced in the latter part of 2008 augur well for the present year. The results of which will manifest after a certain time lag.

¤ Timely changes in Cash Reserve Requirement (CRR) and Statutory Liquidity Requirement (SLR) for effective liquidity management has facilitated banks.

¤ Encouraging aggressive resource mobilization in private sector by catalyzing banks to raise more deposits through imposition of minimum deposit rate of 5% on savings accounts and exempting long tenor deposits from reserve ratios not only allowed banks to encourage savings but address their asset-liability mismatches.

Capital adequacy of the Pakistani banking system is considered to be strong, 12.1 per cent at end-June 2008, well above the internationally acceptable minimum requirement of 8.0 per cent. Core capital constitutes about 80.0 percent of the total capital, and Tier 1 to risk weighted assets ratio of the banking system is at 9.7 percent.

This strong capital base is accompanied by adequate reserves on the back of stringent provisioning requirements against classified assets – the net NPLs to net loans ratio has been reasonably well-contained i.e. at 1.3 percent in June 2008, comparable to international best standards.

The infections ration (net) in June 2008 improved to 1.1% from 1.6% in Dec-2006, signifying that the banks set aside more reserves out of their earnings to cover the increase in non-performing loans.

Going forward, the banking sector faces a significant challenge in maintaining its deposit base and in attracting new deposits, given the three rounds of increase in the rates of return on NSS instruments in the first few months of FY09. This will in a way force banks to enhance the quality and returns on their liability products, and strengthen competition.

However, the financial crisis has different strategic implications for different business lines of banks throughout the world:

¤ Retail Banking: The battle for deposits may determine the fate of entire financial institutions. Quality assets and strong branch networks are also essential.

¤ Corporate Banking: A steep increase in corporate loan losses will force corporate banks to refocus on fundamentals such as pricing and productivity.

- ¤ Investment Banking: Investment banks are radically altering their business portfolios. Many will move from being risk takers to trade facilitators.

- ¤ Asset Management: Asset managers are facing a massive withdrawal of funds. They need to focus on cutting costs and rebuilding trust.

- ¤ Wealth Management: Wealth managers avoided the most severe effects of the crisis but faces challenges that are the result of slumping economies and damage to brands and trust.

The precarious financial situation is not the end of the world, even though things don't seem as promising as they were for Pakistan post 2003 ear but there is still hope, we are a remarkably resilient economy with our unique set of strengths and weaknesses. We are a nation of over 160 million people of which over 50 percent of population comprises youth which means immense potential to grow. Consequently, we can and should depend on our local market. Our indigenous market has got enough strength to attract foreign investment in infrastructure.

Additionally, the ideal strategic location of Pakistan is its greatest strength. We are located in the middle of two great economies which are the pools of the capital; one is Middle East and the other is Peoples Republic of China. As a result, in the next 5 to 10 years there will be rewarding benefits of setting up trade and industrial zones in this part of the world. The agriculture sector is another strong point for Pakistan economy. The only question is to optimize the potential of these areas which only can make Pakistan a self-sufficient country but also one of the reasons that we did not receive the dent of the world financial disaster being at the low end as compared to those having Hi-Tech export markets.

Going forward the financial turmoil has strategic implications for the local financial industry. Banks will have to redefine how they operate:

- ¤ "Focus" will be the watchword for bankers. Large banks will still prosper. In the post crisis world, banks will have to do fewer things and do them very well. In the future, large banks will be "multi-local", concentrating on a smaller set of activities in a more limited number of markets. Around the world, governments and regulators will resist the creation of institutions that are too big to save.

- ¤ Traditional "old-fashioned" banking will re-emerge as the preferred business model, reflecting a more cautions, highly regulated, risk – oriented environment. Customer relationships will take the place of innovative and risk-taking activities as the centerpiece of banking strategy.

- ¤ Deposits will be of paramount importance-not innovative products. Although securitization will not vanish, banks will concentrate on basic products as they focus on generating new deposits-the lifeblood of their business. They have learned the lesson that their modern financial wizards were no more able to turn lead into gold than the alchemists of old.

Pakistan will certainly not witness the financial industry boom the way it did until few years back. Against the backdrop of recent decline in the trend of KIBOR, and the enthusiastic participation of the banks in the last 3 auctions of government paper, reflects a healthy liquidity position of the market. At the same time, we are optimistic about improving fundamentals of the economy as the recession cycle dampens eventually leading the banking industry to spring back into auction full steam.

Monetary Policy Pakistan

Pakistan's economy has a history of glory and stellar performance up until FY2006 with booming economic conditions. Consecutively rising GDP growth rates, over US$ 16 billion foreign exchange reserves, FDI inflows crossing a U$ 5 billion mark, reined in trade and Balance of Payment deficits and somewhat controlled political environment against the backdrop of Pakistan being the key ally in fight against terrorism, were the hallmarks of the economy.

However, come the global onslaught of recession and simultaneously on that era we witnessed the condition of our economy sliding down. The GDP growth rate of plummeted from an 8.4% to a meager 2.5% in FY2008. Pakistan's balance of payment came under extreme pressure in 2007-08, this was largely attributable to the soaring commodity price of oil when it almost hit US$ 200 a barrel, skyrocketing our import bills to an unmanageable level. The food price rose to unprecedented levels amidst the rising prices of others commodities. The stress on macroeconomic stability was most visible in an unsustainable balance of payments position and the falling value of the rupee.

Together with this, escalating CPI inflation, driven by structural problems such as power shortages leading to a gradual decline in real economic activity, aggravated the pressure. The enormous size and skewed financing mix of the fiscal deficit the tilted heavily towards central bank borrowing, liquidity shortages in the money market, and strains in the overall banking system added to an already worsening situation. The domestic socio-political upheavals and rapidly changing global economic environment also contributed to these multifaceted problems. This was the time when the political landscape of the country was not in its best shape either.

A transition of the ruling government was taking place and settling down was a distant possibility. During this era itself, policy measures were not executed properly and those which were diagnosed did not seem to be in coordination with the rapidly changing fundamentals of the economy. Amidst this, Pakistan's foreign exchange reserves continued to diminish at alarming level. The country almost reached the brink of possible default which raised concerns from the world. It was at this time that IMF proposed the rescue package of US$ 7.6 billion up until 2010. One of the objectives of the IMF programme was to restore the confidence of domestic and foreign investors by addressing macroeconomic imbalances through tightening of fiscal and monetary policies.

It was this situation which led to fiscal and monetary policy being tightened. The budget deficit was targeted to decline from 7.4 percent of GDP in 2007-08 to 4.3 percent in 2008-09, and the current account deficit was targeted at 5.9 percent of GDP-down from 8.4 percent in 2007-08. Tight fiscal policy was needed to curtail aggregate demand and support improvement in current account deficit. A tight monetary policy was needed to restore confidence in the Pakistani rupee, help rebuild foreign exchange reserves, ensure domestic financing requirement of the government is met through market placements of the government securities and sharing off aggregate demand by reducing import demand for which higher interest rates were needed.

Incidentally, while Pakistan has been on a contractionary policy drive, the entire world has been expansionary in their stance towards policy rates. This drew criticism from various quarters. However, the rationale behind this has been that the world demand had been shrinking due to after effects of heavy recession whereas the conditions in Pakistan still heralded high demand which has been obvious from increasing fiscal and current account deficits and had to be curbed. Fiscal deficit is expected to be 4.3 percent of GDP-down from 7.4 percent and the current account deficit is likely to be 5.3 percent of GDP-down from 8.4 percent last year. Such a sharp reduction in macroeconomic imbalances in one year is a significant achievement.

However, as things seem to ease a bit, after witnessing a difficult year. There has been steady improvement in key indicators. CPI inflation is on a downward trajectory, government from the Central Bank has been curbed within reasonable limits, the foreign exchange reserves have gone up. While solutions of structural impediments take place in the backdrop, monetary policy can take lead in nurturing expectations of declining inflation and improving macroeconomic imbalances, simultaneously supporting real economic activity. IMF observation mainly requires from the policymakers that a tough monetary stance should continue as there are indications that inflation is likely to surge again due to possible electricity tariff increases, and the rebound in oil prices. However, the relaxation of the fiscal policy stance will add to inflationary pressures. Moreover, the present round of wage increases in the public sector, if not managed properly, may trigger an economy-wide realignment of wages, with attendant effects on inflation and competitiveness.

Against the back drop, Monetary policy 2009-10 was announced recently, where the Central Bank has reduced bank's key policy rate by 100 bps to 13%. SBP has in this policy introduced a corridor for the money market overnight repo rate effective August 17, 2009. While the SBP Policy rate will serve as a ceiling, the repo rate on the new overnight deposit facility, 300 bps below the SBP policy rate, will provide a binding floor. The introduction of the framework is expected to improve liquidity management, enhance effectiveness of market signaling, foster stability and transparency in money market operations. The frequency of monetary policy announcement will increase from 4 times to 6 times in a year. These positives have reflected a contraction in aggregate demand in the economy and has led to the much needed fiscal consolidation with a subsequently improved balance of payments position. The consequent impact can be witnessed by the interbank money market functioning smoothly, the stability in the foreign exchange market within a tight range while the deposit growth in the banking sector seems to be picking up. The overall banking spreads are also hovering around 5-7%. However, NPLs continue to haunt the banking industry and have grown two fold over the last 2 years. Although a certain school of thought portrays that the decrease in the policy rate by 100 bps (discount rate) would not have any impact as its impact is well offset by the depreciation of the rupee in recent weeks.

The rupee has depreciated by 3 percent against the dollar in the recent past, which has resulted in making import of raw materials as well as other things more expensive and net impact of decease in policy rate stands challenged in terms of likely increase in aggregate demand in the country.

Linking it to possible likelihood of the resurgence in inflation, the increasing trend in international commodity prices might halt the declining trend in domestic inflation. Rise in prices of metal, sugar and crude oil indicate towards the significance of inflationary risks.

The new policy has raised concerns in the markets, as the decline in discount rate is expected to bring down the movement of market related interest rates in the upcoming days. Markets feel that the cost of the borrowing is still high and needs to be curtailed further in order to revive the economy so that investment can pick up. The Central Bank has not made any changes in the CRR and SLR composition as the policy rate has been altered. Hence it is generally felt in the business circles that further easing of monetary policy would be a welcome step.

On the other hand, the government has already linked the reduction in the policy rate with the decline in overall inflation especially the core inflation in the country. The overall inflation is witnessing a declining trend. However, apprehensions are also being expressed that inflationary trend might reverse due to the behavior of the international commodity market. The relaxation of the fiscal policy stance does not enable the government to achieve desired result in the months to come.

Although a 1 percent cut in discount rate is a welcome step, but there is still room for a greater expansionary monetary policy. It is felt that the economic growth would only pick up when the cost of doing business will improve. Except food items the demand for all other products has generally dampened as consumers' do not have enough resources.

Nevertheless, the reduction in the monetary policy review period is a positive measure as it would help in addressing issues in a timely and structured manner. Incidentally the government and the SBP have undertaken a historic Pakistan Remittance Initiative that will bring a fundamental change in the country's remittance regime to boost and facilitate the flow of remittances sent home. The new process is meant to facilitate both the remitter and the beneficiary by making the procedure real time and electronic through development of integrated and secured payment system infrastructure. As a first step, 5 banks have been added to take up this initiative and perhaps additions will be made as the process shapes up. This initiative would ensure that participating banks take adequate controls in the process of transfer and payment of remittance through beneficiaries' accounts and over the counter payments. Financial institutions will have to be further strengthened for AML and KYC purposes. This is a positive step to enhance the remittance flow and will add significantly to the country's financials.

The Year 2009 in Retrospect

The year that was, has been bid farewell with an ambivalent note amongst various circles including economists, analysts, politicians, professionals, students and speculators. If the business cycle of the economy was to be charted, we would notice an eclectic mix of trends vis-à-vis different macro-economic fundamentals including inflation, foreign exchange, current account deficit, and commodity prices, fiscal and monetary policy.

Pakistan's economy grew by only 2 percent in 2008-09, against the target of 4.5 percent, due to poor performance of almost all sectors, coupled with internal and external pressures. Agriculture has been the only sector, which demonstrated some growth, mainly because of weather conditions and good support price to wheat growers.

The intensification of war on terror into settled areas, coupled with older domestic factors like political turmoil and an unstable law and order situation, acute energy shortages, supply shocks, augmented by external factors like worsening of international financial crisis feeding into shrinkage of external demand and uncertainty about global recession, tested the resilience of economic fundamentals. The poor resource mobilization efforts remained the hallmark of the economic policy in this period and exacerbated vulnerabilities to external shocks. The domestic factor behind the higher growth of the previous years was a consumer boom on the back of enhanced access to credit which was likely to slow down once the demand for durables reached saturation level.

The productive capacity of the economic remained alien to this higher growth and new industrial or energy capacity never received due attention. The growth of 2008-09 must be viewed in the backdrop of regional and international developments where real GDP in Pakistan's main trading partners contracted by almost 3 percent on average in 2009, depressing the external demand for Pakistan's exports. The services sector grew by 3.6 percent as against the target of 6.1 percent and last year's actual growth of 6.6 percent. Pakistan's per capita real income rose by 2.5 percent in 2008-09 as against 3.4 percent last year i.e. 2007-08. Per capita income in dollar terms rose from $ 1042 in 2007-08 to $ 1046 in 2008-09, thereby showing marginal increase of 0.3 percent. Real private consumption rose by 5.2 percent as against negative growth of 1.3 percent attained in 2007-08. However, gross fixed capital formation could not maintain its strong growth momentum and real fixed investment growth contracted by 6.9 percent as against the expansion of 3.8 percent in 2007-08.

The Central Bank operated with a contractionary stance in terms of its monetary and fiscal policy to curb excessive inflationary tendencies in the earlier part of the year 2009. This tool proved to be quite instrumental as the beginning of the year witnessed headline inflation at the rate of 25.3 % down to almost a 13.1 % towards year end 2009. In particular, a sharp downtrend in food inflation was a welcome development as this component of CPI affects mostly low income groups. CPI food inflation fell from its peak of 34.1 % YoY at the start of the year to 17%. The downtrend in inflation owed to favorable international and domestic developments in addition to a deceleration in domestic demand. The latter in particular reflected the monetary tightening by the State Bank, as well as the complementary improvement in fiscal discipline. It is worth noting that the acceleration in the fall of inflation became visible only after the monetization of the fiscal deficit was halted. In order to support industry particularly export oriented sectors which were pressured by the impact of the global recession the SBP introduced measures such as easing access to concessional financing schems and lengthening maturities. The Central Bank also injected appropriate liquidity to meet banking system's increased demands for commodity operations and settlement of circular debt. At mid-year, broad money growth weakened, down from 8.4 % at the beginning of the year 99 to reflecting continued deceleration in domestic demand. The SBP in the last year shifted its policy towards supporting the growth in the economy. These steps improved other macroeconomic factors also subsequent to discount rate cuts. The economy continued to be fragile despite the measures taken by the Central Bank. Because of the stabilization measures, fiscal deficit was substantially contained at 5.2 per cent of GDP in fiscal 2008-09 down from 7.4 per cent in previous years while there was elimination of subsidies as well as a cut in development expenditure.

Also the current account deficit which consumed a phenomenal part of economic think tank's time experienced a plummet. The current account deficit narrowed substantially with a corresponding stability in exchange rate, while fiscal discipline was maintained with the fiscal deficit being reported to be 3.1 % of GDP for 2009.

The tax policy again took an aggressive outlook as the year 2009 witnessed aggressive overtones of tax net expansion. The attributes of taxes are regressive in nature, since there has been no let-up in the current state. This has proved to be challenging for the common man and has also disturbed the factor of social and health service standards of the masses. Abolition of power subsidies also has contributed to the woes of the masses in the year 2009. The current stance, however, atleast towards year end, has been that developmental expenditure should not be curtailed as it can have devastating effects on the country's physical and human capital infrastructure. The fiscal improvement has largely been based on reduction of oil subsidies and a cut in development spending. All meaningful efforts to expand revenues, particularly by broadening the tax base, will only work in the medium term.

The financing patterns of fiscal deficit remained dominated by the banking system, which financed 85 percent of the fiscal deficit and only 15 percent were financed by the non-bank sources. The government remained prudent and over-performed with respect to the SBP financing limit allowed by the Economic Stabilization Program.

Exports were targeted at $19.0 billion, or 6.9 percent lower than the previous year. Exports started to face heat of global recession since January 2009 and the contraction of world demand for major exports exacerbated export contraction. The exports witnessed negative growth of 2.37 percent- declining from $16.4 billion of last year to $16.0 billion in July – April 2008-09. However, exports fell by 25.9 percent in mid-year 2009 over mid-year 2008 which has been really worrying for the economy.

Imports registered a negative growth of 7.1 percent in the year 2009. The imports stood at $ 26.77 billion in 2009 as against $ 28.715 billion in the comparable period of last year. The growth in imports reflected impact of substantial fall in oil and food imports in monetary terms and these two items were responsible for 80 percent of additional import bill of 2009. Import compression measures, coupled with massive fall in international oil prices, started paying dividends and imports witnessed marked slowdown during the last two months. Workers' remittances totaled $ 6.4 billion in 2008-09 as against $ 5.3 billion in the comparable period last year, depicting an increase of 20.6 percent. Deep recession in the US economy, which constitutes close to one-third of Pakistan's remittances, started taking its toll and witnessed negative growth of 1.9 percent. The trend is expected to continue in the months to come.

Foreign Exchange Reserves declined substantially in the initial months of 2008-09, dropping from $ 11.4 billion at end-June 2008 to a low of $ 6.4 billion by November 25, 2008. This depletion of reserves in the five months was lower than fall in forex reserves for the whole of 2007-08. The subsequent partial recovery in November 2008 owed essentially to the inflow of $ 3.1 billion from the IMF following Pakistan' entry into a macroeconomic stabilization program. The import coverage ratio declined to an uncomfortable level of 9.1 weeks as of end-October 2008 from 16.8 weeks of imports as of end-June 2008, but it improved to 18.0 weeks of imports by end-April 2009. But with the assistance of IMF disbursements, SBP foreign exchange reserves rebounded to about $ 9.1 billion (2.9 months of imports) by end-June 2009.

The first two months of FY 2009-10 suggest that fiscal instability is likely to continue, and the first quarter fiscal deficit target may exceed the estimates. Revenues have contained to underperform. Failure to raise revenues in future would further intensify Pakistan's vulnerability to external shocks, and jeopardize development efforts by limiting resources available for planned investments in human and physical infrastructure.

Pakistan's banking sector has shown resilience to the weak macroeconomic environment even though it experienced a drop down in deposits. Circular debt is another critical issue which is still a potential indicator of the economic problem. Billions of rupee have to be settled with the Oil Marketing Companies and Independent Power Providers. The long hours power failures have not only affected the common public, but shut down businesses. The forecast for the year 2010 as per the analysts is a mixed sentiment altogether. The economy seems dependent on foreign donors to a large degree. A possible hike in commodity prices especially oil and food might feed inflation later on. There is a subdued sentiment as far as respite in domestic liquidity crunch is concerned as it is most likely to stretch for a longer duration if an extraordinary external support is not received. Healthy revenue collection can also provide some relief.

Despite all these tribulations the year 2010 seems promising.

Credit Risk Evaluation

Preamble

The process of assessing credit can be performed scientifically and objectively, but fundamentally the decision to lend is subjective in nature! In simple words, the process by which a lending decision is made is and will always be subjective. You have and will continue to have scientific and mathematical tools at your disposal, but there will never be an alternative to your gut feel that will obviously have the backing of these scientific tools. In Pakistan, the decision to lend is complicated further by the lack of upto date financial information on the borrower.

Against this backdrop, the only way to surmount and compensate for this problem is to engage in a careful, conscientious and objective analysis of the client's business and the particular transaction being financed. In this paper, the objective is to highlight factors that a lending banker must consider while assessing credit risk. In practice, it might entail difficulties in successfully accomplishing such criteria, yet it is important to go through the discipline of properly analyzing and documenting risks in each credit proposal. Though you may have many tools at your disposal, please do bear in mind that these are tools that contribute a specific percentage towards your final decision. No one tool has the absolute capacity to determine what the final decision will be. They will contribute specific weightages and it is upto the analyst to derive whatever benefits he/she wishes to. These tools being scientific in their outlook; never lie – that has to be borne in mind.

Lending Proposal – Inherent Risk

"What is the loan for and how the loan will be repaid and who the borrowers are?" there? These are some of the questions that have to be answered before the analyst sets about his task of risk evaluation and taking a decision in the matter. One of the primary fault in credit proposals is a failure on the part of the lending banker, to detail what the money is to be used for and how it will be repaid. One may know what the purpose of lending is, but not documenting it, in effect, takes that element out of the equation. Since we are in the risk-taking business, the idea is not to run at the first sight of risk – rather it is to identify the risk, document the risk (most important of all), and then contemplate what the possible mitigates could be. An analyst may conveniently find a manner in which to plug in a risk after having thought over it, but unless you document what the risk is, the chances are that the risk will be overlooked. It is, therefore, of the utmost importance to document any and all potential risks. The folliest credit decision is to lend against the net worth of a company/individual or placing reliance on security as a source of repayment. Even worse would be ignore any one tool even if the perceived weightage is only a few percentage points. That will be a decision that much weak and deficient.

It is important to know that the source of repayment, for any loan, will largely depend on the "type of finance" being extended. While taking any kind of a financing decision the source of repayment has to be identified and quantified, and potential variations thereto, factored in as well. Three major types of finance, commonly used in Pakistan, are the following. With the passage of time, many additions and variations will be made to this list, but all forms of financing will more or less be revolving around these three kinds:

¤ Working Capital
¤ Trade Financing
¤ Project Finance

Based on the above types of loans and advances, we can now consider the various risks that are associated with each type of finance. Basically, what is financing? A detailed note can be prepared on the financials of any concern but at this stage, two topics need highlighting – the definition of a Balance Sheet, and the various broad sections of a Balance Sheet. The most pointed definition of any Balance Sheet is LIABILITIES REPRESENT AND QUANTIFY SOURCES OF FUNDING MADE AVAILBLE TO A CONCERN whereas ASSETS REPRESENT WHERE THOSE SOURCES WERE DEPLOYED AND IN WHAT AMOUNT. On the Liability side, you have the Net Worth Section which represents PERMANENT CAPITAL (never to be taken out in normal circumstances). NON CURRENT LIABILITIES that have to be repaid either to banks or other sources but after a period of one financial cycle, and CURRENT LIABILITIES, that have to be repaid to banks or other sources during the next financial cycle. On the Assets side, you have Fixed Assets representing those assets that are essentially of long term nature and have a productive usage, Current Assets that have to be turned over within the next financial cycle, and other Non-Current Assets that are neither fixed not current in nature. Since, the Liabilities and Assets both have corresponding sections, financing could be defined as the bridge between specific sections of the Assets and corresponding Liabilities to ensure harmony in the Balance Sheet.

WORKING CAPITAL FINANCE

Under such financing arrangements, repayment is expected to come from the general cash flow of the company. And within the General Cash Flow of the Company, specific sources have to be identified and quantified. The lending institution should, therefore, invariably insist on seeing a comprehensive cash flow statement/forecast for the company. No company develops problems overnight; it is the trickles that suddenly gush the problems to prominence. The traditional ratio analysis of financial statements does not reveal the existence of problems; it is only a careful anaylsis of the company's cash flows, that would reveal impending doom, most likely before it collapses. No amount of profitability, turnover and liquidity ratios can convey the striking features that a cash flow statement can provide. If there is no net generation of cash internally, then this characteristic itself is a fair indication and an early sign of gathering problems. And also do bear in mind that a very impressive ratio can also hint at a pending doom. Each ratio has an optimum range within which that ratio could be considered as healthy. Beyond that range either side would indicate sudden doom or pending doom. Either scenario must be investigated to arrive at conclusions as to why the optimum range is being breached. The explanation could either be genuine and innocent, or could hint at something more serious than it appears to be.

If a company that wishes to borrow working capital finance, shows inability to supply a cash flow forecast, then it must evidence very clearly to the credit officer that the company itself is 'unsure' of how the advance will be repaid. This situation obviously increases credit risk.

Having acquired a properly drawn cash flow and cash budget forecast, the lending banker must consider the following:

¤ Review in detail the assumptions underlying the cash flow forecast.

¤ Review the general risk associated with the company, anything with the least likelihood of impacting the achievement of the forecast.

While reviewing the forecast, attention must be given to the following:

¤ Have all cash flow factors been included i.e. tax payments, dividends, capital expenditure, royalties, bonuses, principal and interest payments?

¤ Is the gross margin reasonable and consistent with industry averages; how does it compare with previous years?

¤ Has the inflation factor been given due weightage?

¤ Are the interest rates and currency rates reasonable and in line with market conditions?

¤ Has a contingency factor also been factored in?

There are cases where the cash flows are perfect, but still financings go south, and the reason invariably is that possible contingencies were not accounted for.

In the assessment of the general risk, following factors require an indepth analysis:

I. Business Risk

This essentially includes industry risk, market risk and supply risk.

Industry Risk:

¤ Concentration of sales on any one industry enhances risk.

¤ Product's life cycle – the shorter it is, the higher is the risk (e.g. Fashion-wear).

¤ Existing and anticipated Government policies/restrictions.

¤ Current levels of competition (any over supply) can increase the risk of reduction in profit margins.

Market Risk:

¤ Concentration of sales from one single geographical area.

¤ Concentration of sales to a single buyer.

¤ Reputation of buyers.

Supply Risk:

¤ Concentration of purchases from any single geographic location.

¤ Concentration of purchases from a single supplier.

¤ Single currency exposure in respect of purchases.

¤ Reputation of suppliers.

II. ORGANIZATIONAL RISK:

¤ The quality of management and shareholders. Their track record in their line of business.

¤ Evaluate existence of any un-due reliance on key individuals – would 'succession management' be easy?

¤ Are all directors resident – a non-resident director may easily walk away from commitment.

¤ Shareholders Commitment to fund expansion of business, continuous high dividend policy is a danger signal.

¤ Attitude of Management, is it conservative or speculative?

¤ The existence and quality of internal control system. Poor control systems are reflected in over-stocking. Invoicing which can lead to both errors and frauds.

III. FINANCIAL RISK:

¤ Interest and exchange rate sensitivity analysis to both assets and liabilities.

¤ Balance Sheet and Capital Structure. Examine closely gearing i.e. debt-equity ratio.

¤ The most misunderstood ratio is the gearing percentage. There are many variants to this ratio/percentage but the way I would look at it is:

To fund the Assets side of any balance sheet, there are three broad sources of funding – internal sources (equity etc. which is also permanent), external sources from banks and financial institutions (funding and loans), and from market sources and others. We tend to consider only lendings made by banks while ignoring market sources, etc. The fallacy here is, market sources ALSO HAVE TO BE REPAID, and since they are in daily and very close touch with the borrower and have no hang-ups pursuing what is due to them (as opposed to us Bankers who hesitate leaving their air-conditioned environs), they will always have the edge on us. They key here is to maintain a harmonized balance between these three components.

¤ We also must look at another variation to the gearing percentage – LEVERAGE. Simply put, this represents the relation between net worth of the company versus all other liabilities. The fallacy that we indulge in here is we only compare the net worth with the bank borrowings "since we claim that we have to use this ratio only to satisfy the Prudential Regulations". This is where we stumble. All liabilities – other than the Net worth – have to be repaid. The beneficiaries may vary, but ALL LIABILITIES have to be repaid. The question that has to be adjusted here is how many times has the Net Worth been leveraged to generate other sources of funding i.e. liabilities. Prudential Regulations aside, we must determine our appetite in this regard.

In relation to industry standards, check following ratios:

¤ Stock turnover

¤ Debtor's turnover

¤ Current ratio

¤ Liquidity ratio

¤ Profitability ratios

¤ Quality of fixed assets and then ageing

¤ Contingent liabilities

¤ Quality of financial information. Examine accounting policies. Availability of up-to-date audit accounts. The quality of auditors.

¤ Examine and identify those company assets that have been pledged to support facilities granted by other financial institutions.

Financial discipline standards within the company to ensure judicious 'end-use' of funds.

Our financial market is getting complex by the day. With the focus of business houses now on Groups of Industries, the tendency towards inter-company borrowings and investments in heavy amounts, is growing and flourishing. The tendency of Bankers is to ignore this aspect vis-à-vis the balance sheet. We confine our focus to the size of the balance sheet and the group bonafides behind it. Whereas this is equally important, what is of significance (and generally ignored) is the impact that this intercompany borrowing and investments may have on the actual financial health. Suppose for a second that one amongst the group of companies goes south. What drag-down impact will that have on the other group concerns? This will mainly depend on the amount and complexity of such inter-company investments.

Another aspect that nearly always goes ignored is the actual treatment of inter-company investments. Suppose company "A" invests Rs 100/- in company "B". What does this mean? At first glance, this would be seen as it actually is – an investment. Try this version. Company "A" has taken Rs 100/- out of the company (bearing in mind that all other sources have to be repaid) and has invested it somewhere where your access is zero. You would in normal circumstances have no recourse to this Rs 100/- and the health of this investment would also depend upon the performance of the beneficiary company. Do we ever review the performance of company "B"? Never is the natural answer.

TRADE FINANCE:

Trade finance is often believed to be less riskier than working capital finance and project finance, in view of its being, both short term and self-liquidating. The successful culmination of the transaction becomes the source of debt repayment, and there is therefore no reliance on external or balance sheet sources. This in itself is a fallacy. Whereas the trade finance transaction is considered to be self-liquidity in nature, do bear in mind that there could be an angle of speculation and a major degree of reliance on factors upon which we as bankers would have no control.

The positive features that attract lending bankers to finance of trade are:

¤ the use of self-liquidating papers

¤ availability of primary financing and refinancing through secondary market

¤ large inter-related product range with opportunity for creative product mix and multi-party contracts

¤ built in security i.e. goods

¤ possibility of total non-funds based engagement

¤ off-balance sheet financing

¤ greater reliance on undertakings of disinterested third parties i.e. shipping companies, insurance companies, etc.

¤ avoidance, fragmentation and externalization of risks

¤ reliance on international trade, customs, practices, good faith and trust.

In practice, however, trade finance transactions require as much scrutiny and monitoring, as any other type of finance, because of the following reasons:

¤ In many situations, the bank does not retain control over goods right up to the time it is paid. A case in example here is Freight Forwarders Bill of Lading. In this example, the Bank is not even the consignee which it otherwise would be.

¤ A number of trade related transactions are in effect 'clean risk', eg: Pre-shipment finance, export bills etc. where the underlying securities i.e. the goods are easily resaleable nor the 'end use of funds' can be effectively monitored. The underlying goods even cannot be identified.

Therefore, while assessing credit risk, in respect of trade transactions, the factors considered for working capital finance, must be given equal consideration, while additionally following features must be evaluated:

Control over goods – import finance

¤ Repayment is from sale of goods and hence credit risk is directly associated with degree of control over goods. And sole reliance on control over goods is also a sore point. Do please acknowledge one important aspect here – the responsibility to sell the goods upon which your control rests, is solely on the borrower. If the borrower cannot sell the goods or finds it uneconomical to sell those goods, do you really think that a banker will be able to sell the goods and that too at a better rate? Hardly so. The release of title documents to an importer against 'trust receipt' is a weak security.

Trust Receipt may be a weak security as so perceived but then under this mode, the responsibility to protect and take care of the underlying goods is not with the Bank. Depending upon the Bank's ability to take bitter decisions, one can always exercise criminal resource under that Trust Receipt. In our part of the world, owing to social stigmas attached, this could be a very powerful deterrent provided it is used.

If the goods are transported by air, there is no title document. In such cases, bank should be the named consignee, to retain control over goods.

¤ If the goods arrive before documents, bank may be asked to issue shipping guarantees, whereby the bank loses control over the goods. In such cases, taking anything less than 100% cash margin only enhances risk.

Saleability of goods

Even though a bank may maintain full control over the goods, yet these may not be re-saleable easily, if the importer defaults, eg: perishable goods and items manufactured to suit certain specific industry considerations. The pricing structure must be reviewed to see whether the goods can be sold at cost or above cost. This requires importers track record, orders on hand, the markets supply and demand position.

Export finance

The decision to allow export finance is usually based on the general credit status of the bank's customers. Even though the source of repayment may come from the transaction itself, yet banks usually place a good degree of reliance on their 're-course' to the client.

The following aspects need to be considered:

Risks associated with importer:

¤ Reputation and business risk of importer

¤ Political risks – possibilities of outbreak of war, social unrest, etc.

¤ Transfer risk

Risk associated with importer's bank

¤ Credit worthiness of the bank itself

¤ l/C's terms to conditions – simple or complicated.

Pre – Shipment Finance

¤ If given against l/C only, without the support of further collaterals, then it is akin to 'clean finance'. Most risky, since the 'end-use' of funds is outside the domain of check by the lending banker. The chances of diversion of financed raw materials cannot be ruled out. Significant monitoring measures must be adopted to plug this deficiency.

Because of the difficulties in assessing importers and importers' bank risk, the expert financing bank usually places reliance on its recourse to the customer (exporter). In all such cases, the considerations enunciated under working capital finance should be considered and adhered to.

Project Finance

In assessing credit risk, it must be borne in mind that repayment will come from the project cash flows, either through a revenue stream or from the sale of completed project. The under mentioned factors need to be considered:

¤ Viability of the project: This entails a detailed review and analysis of the assumptions underlying the project cash flows, including:

- Anticipated revenue versus market supply
- Pricing structure
- Inclusion of inflation factor
- Consistency with market, in the usage of interest and currency rates.
- Times of inflows to match with timings of due liabilities. These have to be matched carefully.

A sensitivity analysis is imperative to be carried out on these assumptions, to invoke the 'downside' possibilities.

¤ Availability of resources: Bank must examine whether the company possesses sufficient resources to complete the project – resources include both financial and human i.e. management with sufficient skills.

¤ Priority of repayment to ensure that there is no diversion of funds, bank must obtain priority in repayment, it should take an assignment over project revenue, and if achievable, should insist that the revenue should be paid into an account under its control.

¤ External factors, such as government legislations, political uncertainties, etc.

¤ Ability to monitor project's progress and use of funds.

Epilogue

"To avoid all mistakes in the conduct of a great enterprise is beyond man's powers", said Minicius to his soldiers after his defeat by Hannibal in 209 B.C. "But", he continued, "when a mistake has once been made, to use his reverses as lessons for the future is the part of a brave and sensible man".

A major portion of our financial industry's bad loan portfolio of around Rs. 490 billion can be traced to either a willful violations of the fundamentals of credit assessment as discussed above or to a complete lack of knowledge or awareness. The impelling need is for all lending bankers to revisit the fundamentals of credit evaluation. Mr. Micheal LaRusso of the Comptroller of the Currency Office, back in 1980, told the management of Bank America while reviewing their horrendous loan book, "If I were you, I would err on the Conservative side".

Banking and Financial Services – the Backbone of an Economy

In the economic development of any country, independent of stages of development – highly developed, fast growing, emerging or under-developed – the financial sector holds away. The management of the financial resources of a country constitutes the crux – relative both to potent and latent productive capacity of an economy.

The financial resource base of any economy is mostly domestic and partly external. How the total is handled holds the key to development. Except for command economies or near-total centralized ones, the handling of these resources is broadly the responsibility of the fiscal and monetary authorities of the day. The goal of both is the same or needs to be the same in the interest of a sound, healthy and prosperous economy to ensure societal cohesion and such objective conditions as to maximum resource base utilization.

In a qualified sense, the two authorities are somewhat independent of each other but unless independence of both is not secured, the common stated objectives cannot be secured. Both need to fine-tune their policies to achieve growth and contain inflation. In the current world scenario, while some leading economies having over-spent are focusing on reducing their fiscal deficits at the cost of growth leading to protectionist policies, some highly developed economies are pursuing loose monetary policies to spur growth lagging behind needs.

The best of planning may fail and perhaps the worst may succeed, depending upon competent manpower capabilities. This raises the problem of governance is an increasingly globalized economic development marred frequently by volatility, affecting some economies adversely not of their making.

In a number of countries of the world, sufficient importance to qualified manpower development appears to be lacking. Of equal importance if placement of policies to achieving equilibrium level of population. Demographic distortions are as much a malaise of underdeveloped economies as of some highly developed economies. Unless a balance in struck between the resource base of an economy and the level of its population, the so-called globalized village would continue to fail in its often stated millennium goals.

Editorial *(January - March 2012)*

The financial challenges that emerged in the last few years have reinforced the importance of risk management and robust regulatory compliance. Amid headwinds and vulnerabilities, traditional banking functions have stood resolute and continue to provide a strong annuity stream of revenues to support the banking system.

The banking industry in Pakistan – a highly regulated industry – has exhibited resilience in the face of global and domestic economic pressures. The progress of Pakistan's banking industry is reflected in its growth and the increasing sophistication of banking services available to customers. Financial products and services of the traditional banking system are largely pervasive in the consumer as well as the corporate segment of the market, and with technological innovation and advancement, the industry's outreach to more segments is expected to increase. A large portion of the 180 million population of Pakistan still remains un-banked, demonstrating the potential the industry has for deepening its penetration. Leveraging technology, while prudently managing risk and developing the regulatory framework, will prove essential as banks endeavor to harness the existing market potential.

The cover story of this issue offers an analysis of the financial performance of banks in the outgoing year and the sector outlook in the year forward. The issue highlights a trend observation where banks traditionally known as 'medium-sized private banks in the industry are catching pace with the big five. This is indicative of the rising competitive environment of the banking industry and promise it holds.

The issue also presents a variety of interesting commentaries and analyses on topics relating to the performance of the banking industry and components that support its development.

Notwithstanding the difficult operating environment, Pakistan's banking sector has continued to perform well and maintains a positive outlook. We hope that the features highlighted in this issue of the Journal are successful in offering engaging and beneficial information to all readers.

Editorial *(April - June 2012)*

John Fitzgerald Kennedy said, “The human mind is our fundamental resource.” And who would not agree today.

The paradigm was, and in its more reinforced significance in this day and age, continues to be a remarkable advancement compared to the archaic notion the manpower represented physical dexterity; back then, Adam Smith opined that trade and economic growth were a direct consequence of the quantity of manpower and capital bequests of a country.

It wasn’t until the new growth theory was coined that the term ‘human capital’ emerged in the history of economic theory. This has been thereafter referred to by many alternate names, such as, science, technology, institutional knowledge or research and development (R&D). It was until this enlightening period that due recognition was granted to the ‘knowledge worker’ over the ‘manual worker’.

Human capital is the accumulation of competencies, knowledge and attributes of people, this combined potential is embodied in the capability to perform labour and there upon produce economic output. It is imperative to comprehend the divergence between the terms ‘human resource’ and ‘human capital’; human resource is transformed into human capital with the input of education/knowledge, health and acquired/honed competence.

The concept of the human capital is to some extent comparable to Karl Marx’s notion of ‘labour power’ that denoted one’s capacity to work. According to Marx, the conceptual difference between one’s capability to work i.e. labour power, and the actual activity of working, deserved emphasis.

The ideology that human capital is directly related to human development and is an instrument of economic development has become parabolic to an economic myth. It is universally accepted, and tirelessly reiterated, that when there is human development, qualitative and quantitative progress of the nation is inexorable.

However, acceptance of the idea ad discussing it endlessly on much-publicized forums is not the same as developing human capital and translating it into sustainable growth. Pakistan ranks 145th on the Human Development Index – an indicator of positive correlation between human capital formulation and economic development – and is categorized under ‘Low Human Development”. Pakistan’s economy has grown at a relatively stymied pace in the South Asian region; we are not the victims here however, as we ourselves have not realized and actualized our abundant potential. We have not invested in human development and hence have not witnessed its payoffs.

With 63 percent of its population under 30 years of age, Pakistan has been blessed with a population mix that is brimming with potential that needs to be harnessed. Machines and technological capital are a mere means. What must precede it, is the development of people in the economy from grass roots levels. This can only be done when education at the tertiary and vocational levels is given supreme priority.

The banking sector is oft-considered a nation’s economic engine, as it provides financial support to the real sector and facilitates financial intermediation between savers/investors who are looking for ROI and consumers/businesses who are looking for access to credit and capital. Pakistan ranks 55th as per the Financial Development Report 2011; only Bangladesh, Tanzania, Ghana, Venezuela and Nigeria trailing shortly after it on the Index.

This state of affairs is attributable to the diminutive emphasis on training and development of human capital – an activity that is still 'booked' as an expense rather than an investment. Cost-reduction, return on stockholders' investment, profitability, mobilization of deposits, enhancement of asset quality and 'right-sizing' are the banking orders of the day. What is glaringly missing from this mix of indicators that banking strategy mostly revolves around, is the quality of human resource, which is what ultimately determines the performance and future of an organization.

In this age of global integration, where cultural demarcations are gradually fading into oblivion and we are becoming an increasingly connected population with blurred boundaries, organizations' people are emerging as the drivers of the only business concept that can yield sustainable competitive advantage – continuous innovation. In such a competitive and dynamic business environment, it is not physical acumen but meticulously honed, superior human intellect that delivers results.

US banker, Walter Wriston, once said, 'Many organizations are now trying to walk under the banner of The Learning Organization, realizing that knowledge is our most important product...But the only place that I've seen it is in the Army. As one colonel said, "We realized a while ago that it's better to learn than be dead". It is high time that our organizations also realize that learning and development of their people is crucial for their survival – and on a macro-level, sustainable economic progress.

Editorial *(July - September 2012)*

Corporation in general and banks in particular, have in the recent past embraced the realization that good corporate governance and greater transparency are necessary imperatives for business, and are actually in their self-interest. It is due to this shift in paradigm, that corporate governance is the mantra-of-the-day at regulatory, legislative and organizational levels.

Corporate governance entails the balance of power and mitigation of conflicts of interest between the managements, board of directors, shareholders, and other stakeholders in a company. It is through these relationships that a framework for architecting corporate objectives and monitoring performance is designed. In essence, corporate governance refers to the structures and processes that provide direction to, and enable control of operational performance of organizations – and through which the afore-mentioned conflicts of interest are allayed. A central aspect of corporate governance is the nature, scope and degree of accountability of people in the organization.

Regulators, industry participants, academic institutions and non-governmental organizations have exerted dedicated efforts to raise awareness of the significance of sound corporate governance; to this end, various institutions, which aim to propagate understanding of the referenced subject, have been established.

Corporate governance is a key indicator of the soundness of the financial system and its ability to withstand economic shocks. The health of the participants of the industry is determined by their respective abilities to identify, measure, monitor, and control their risks. The existence of systems which ensure the banks are approximately and strongly governed, and that both operational and moral malpractices are avoided, are a prerequisite for sound corporate governance of banks.

Corporate governance emerged, and gained recognition, as particularly relevant and important within banks, in the aftermath of several episodes of banking crises in the 1900s. This importance was, and continues to be, further accentuated by the market development which outpaced the relatively slow growth in information distribution.

Moreover, globalization, deregulation and technological advances have increased the risks imbedded within the banking system. These risks, and the negative impact that results therefrom, threaten to not just be constricted to the stakeholders of specific banks, but also pose the danger of spilling over and negatively impacting the stability of the entire banking system – due to the functional scope and inter-connectedness inherent in the financial industry. Compelled by this standpoint, the State Bank of Pakistan issued guidelines and instructions that address the code of corporate governance of banks, in 2003. In fact, this initiative by the Regulator was an extension of the policies that were designed to reform the financial sector in Pakistan in early 1990s. Thereon, the issue of corporate governance in banks received special attention in Pakistan because of the restructuring and privatization that was taking place in the Country's banking industry.

The Code of Corporate Governance stipulated by the State Bank of Pakistan was revised earlier this year, in 2012. The revised Code further refines its earlier version, and in doing so upholds the universal principals of corporate governance that include equitable and rightful treatment of shareholders, protection of interests of all stakeholders, ensuring integrity in organizations' operational performance and promoting ethical behavior, delineation of roles and responsibilities of the Board of Directors and guidelines for appropriate disclosure and transparency.

It is imperative to understand, however, that regulatory supervision can counter the effects of weak corporate governance to only a limited extent; sound internal corporate governance practices are integral for any sustainable and significantly beneficial long-term effects. Furthermore, good corporate governance practices are not an insurance against fraudulent activities and corporate misdemeanors – they are a tool for control, monitoring and prevention of the same.

To enhance the quality of corporate governance in Pakistan, bankruptcy courts with experienced judges need to be established and organizations – especially family – owned businesses need to be prepared to incur the cost of transparency that sound corporate governance practices are geared towards. For an emerging market like Pakistan, this improvement in corporate governance will reduce its susceptibility to financial crisis, facilitate development of its capital market, strengthen investor confidence and significantly contribute to economic development by boosting corporate performance and behavior.

Editorial *(October - December 2012)*

With democratic influences asserting themselves, social film-production receiving acclaim in the form of the prestigious Oscar and judiciary brining the establishment within the line of law, the year 2012 gave Pakistan much to cherish and remember. Unfortunately, however, the economy was seen to be an underdog at best and failed to leave any triumphant imprints on the sands of the now-previous year. Malala took a bullet, and in doing so breathed life in patriotic unity, yet it was the economy which bled a little with no terrorist pressure at direct blame.

The sluggish economy was certainly not the item of priority on a governmental agenda driven by and revolving around the upcoming elections, as policy inaction emerged as the order of the day and populist measures were announced. Budget 2012-2013 remained evasive when it came to fundamental structural issues plaguing the economy such as the taxation net, RGST, energy crisis and the ill-efficient public sector. Meanwhile, the monetary directives issued by the Regulator continued to reduce the financing cost of the fiscal deficit as the discount rate was cumulatively reduced by 450 basis points over a period of 16 months, despite an inflated budget deficit of 8.5 % of the GDP depicting excess demand in the economy.

For most part of the year under review, Pakistan operated in a disinclined external economic environment and failed to strike good relations with the IMF and other international financial institutions. In FY12, economic growth was recorded at a far-from-impressive 3.7 % per annum, while domestic investment was witnessed at its lowest in 60 years, foreign investment plummeted and domestic saving also experienced a sharp decline. Fiscal indiscipline, escalating budget deficit and government borrowing to finance the same, has pushed the country debt to a staggering 62.60% of the GDP and the energy conundrum, ailing public sector and deficient revenue generation/taxation offer little prospect of relief to the fiscal and debt horizon.

Inflation, surprisingly, stood out as a beacon of economic hope, as it was logged at 6.9 % year-on-year, and in doing so, decelerated at a rate that was faster than projected. Despite this inflationary respite, and a relaxed interest rate regime, private sector credit remained subdued and continued to restrict economic potential, while government from the banking system augmented by 26.4 % on a year-on-year basis.

As per provisional estimates, GDP growth is expected to continue in line with its current lackluster trajectory and close FY13 between 3-4%. External current account, meanwhile, is expected to close at an improved 1% GDP due to lower international oil prices and Coalition Support Fund tranche receipt; these positive developments in the external arena shall, nonetheless, not be able to prevent foreign reserves from dwindling further. Debt repayments to the IMF and the dried-up inflow of foreign investments have resulted in a decline in foreign exchange reserves in SBP, with the rupee depreciating by approximately 5% in 2012.

A few weeks into 2013, here is what hope is for: that our economy fortifies and restores investor confidence so that revived foreign capital inflows can provide stability and strength to our currency; that the private sector's credit demand picks up and takes the economy's production capacity and growth soaring with it; that the government evokes fiscal frugality by mobilizing financial resources, broadening the tax net and streamlining expenditure; that Pakistan finds within itself, that forte for which it doesn't need to go to the IMF's window.

Areas of Focus 2013

As the banking sector closed its respective books on the 31st of December, 2012, it did so with a pinch of salt. And the pinch was note just restricted to that, as the effect of the downward revised interest regime and enhancement of minimum return on savings accounts translated into stunted earnings and reduced net interest margins by constricting interest yield and swelling cost of deposits.

Meanwhile, deposits continued their growth trajectory, and risk – cautious banking funds were subsequently channeled more towards investments – particularly government paper than advances. Going forward, anticipations of monetary expansion are expected to further boost the deposit base of the banking sector; this, along with maintenance of current interest levels and lower provisioning are projected to alleviate the pressures of the SBP directives to pay profit on saving/term deposits based on average monthly balance rather than minimum account balance and the minimum rates, thereof.

As banks gear up for amplifying profitability in the current year, functional ambits which will be critical importance in this year of growth are: internal controls compliance and audit. Effective internal controls are the foundation of prudent and sound banking. A structure of operational and financial internal control that is well-framed and consistently enforced facilitates a bank's Board of Directors and management to safeguard the bank's resources. It assures them that the bank's operations are efficient, effective, and that its risk management systems are robust.

Moreover, robust internal controls provide assurance that the bank complies with banking laws & regulations, in addition to internal guidelines particularized by the Management and the Board. They also diminish the probability of the occurrence of any irregularities and ensure their timely detection when they do occur.

It is imperative to understand that – though closely related – the functions of internal control and internal audit are fundamentally different in nature, objective and purpose. Internal control entails the systems, policies, procedures, and processes that are affected by a bank's Board of Directors and management to safeguard its assets, eliminate or control risks, and achieve objectives. Internal audit, on the other hand, provides an objective and independent review of the bank's activities, internal controls, and management information systems to assist the Board and management in assessing internal control adequacy and soundness.

A bank's management should design a sound system of policies, controls and procedures that ought to be institutionalized through top-down communication of a strong and integrated culture of compliance; this compliance culture should be further strengthened by being embraced and practiced more diligently by the whole human resource body of the institution. The compliance function is of crucial importance as it liaises with regulators, ensures regulations are adhered to, assists with training employees on regulatory matters and makes certain that policies and procedures stay aligned with regulations and any changes therein.

However, while the Management can design, delineate and communicate an internal control environment, in addition to a strategy, objectives and business initiatives, it cannot implement the same without the support of its human capital muscle – that is, each and all of its valued employees. Hence, banks' efficacy, the all – important and distinctive dynamic of competition and its financial performance is contingent upon the dedicated efforts of its team. Banks' bottom line and efficacy, the all – important and distinctive dynamics of competition and financial performance, therefore, are architected and supported by their human resource bodies – which makes developing and empowering the employees a critical strategic functional arena to focus upon in 2013.

Responsible Innovation in Banking

Banking, in its most primeval practice, can be traced back to 2000 BC in Babylonia; a more evolved and relatively modern form of banking dates back to early 14th century in Italy. But the IBP is not a historical journal and this editorial is not an extract therefrom.

With its prehistoric pedigrees, the now increasingly dynamic and crucial economic backbone industry of banking has undergone many changes and phases. Lending in grains and barter paved way for the many shifting forms of currency transactions and now boast a vast portfolio of structured products and services customized as per the financial requirements of customers. Reviewing its history makes one appreciate how critically innovation is interwoven into its evolvement, and how the industry has completely transformed into the global financial landscape we witness today.

Could such progress have been achieved with conservative stagnancy instead of proactive innovation? The answer is simple and broad-spanned – sustainable growth rarely generates out of a conservative maintain-the-status quo strategy, significant advancement calls for us to exit our comfort zones, try something new, even fail sometimes and learn from our lessons, but keep moving forward. There is always room for improvement and therefore, innovation. Bankers better keep their seat belts on, because there are still many phases of innovation to steer ourselves through.

Innovative ideas are manifest in different forms. Innovation in product development is one of the forms that has been subject to much criticism following the recent global financial crisis. Structured products, in particular, bear the lion's share of suspicious critique with reference to the financial turmoil that we continue to witness today. This has also led to the term of reference that the bearers and conducers of financial modernization must embrace in practice: "responsible innovation".

A financial institution's – just like any other corporation's – foremost obligation lies to its stakeholders; banks must cater to the financial needs of its customers, and flexibly design product offerings accordingly, but in doing so it must not lose sight of its primary duty to protect its stakeholders' investments. In the event that banking institutions get carried away at the back of their temporarily unbridled ambitions, internal risk management functions and external regulatory bodies have been assigned the authority to bring them back in line within banking and investor law. Therefore, it is a cautionary imperative for financial and regulatory reforms to complement financial modernization.

The relatively unsung, and less touted, technological innovation has proven to be the fundamental driver of growth and globalization of the banking industry. Anyone who has ever transmitted funds across the world almost-instantaneously, bought something from three continents away by punching in a credit card number and withdrawn money on-the-go from the godsend ATMs, can testify to that. In the obvious presence of these, there is little need to further delve into examples of the compliance controls, transactional convenience, trading platforms and report generation capacity that information technology and its systems have bequeathed to us, in order to illustrate the subject point.

At its crux, and broadest, innovation in any sphere and industry is a creative mindset – a paradigm of thought, a cognitive approach and an institutional culture that must be inculcated within and encouraged by banking institutions. It is the ability, willingness and freedom, to think out of the box even if it is to achieve the same outcome as any other conservative approach, but through a different route. And there is no reason that a conservative outlook cannot be conducive for, or facilitate innovation – the tried and tested old can often times serve as an efficient check and balance for the new.

A good measure to add assurance and certainty into innovation advancement in the banking sector is to design the same such that it improves modern financial systems for the real economy's development. The past twenty years of financial innovation – and the lessons / experiences therein – teach us that dichotomy between the financial sector and the real economy bodes turmoil for both realms. Highly leveraged trade and funds generation through interest mechanism does yield in financial highs and economic booms – but when it fails, it experiences an unprecedented fall too.

Exemplary case in point: micro-saving and micro-investment programs that encourage individuals and households to save small amounts over significantly long time periods. These are outcomes of creative product development that promote financial inclusion while contributing to the augmentation of quality economic output.

They say that those who forget the past are likely to fail twice as much. Let us learn from mistakes that aggressive growth oriented banks (and other financial institutions) have made in the past, and head forward into the future armed with our creativity and sound financial controls. With an armory so well stocked, no milestone will be far enough.

Editorial *(July - September 2013)*

Business ethics, as a jargon and formal concept, graced the corporate stage for the first time following the US Civil Rights Act of 1964. The Act outlawed discrimination on the base of race, ethnicity or religion in business and public institutions.

A banker is a custodian; and it is his/her duty to safeguard not just the finances of the customers, but also their trust. There isa professional and moral obligation to determine the end use of money, after cautiously evaluating the risks and ethical considerations involved.

Globalization, dynamic environment, social interconnectedness, deregulation and technological advancements have aggravated the challenges for ethical business conduct and practices. When the bottom line, business growth and ethics are at crossroads, there is a need to rise above the numbers and decide the course of action based on panoramic deliberation.

External ethics encompass business practices and the impacts thereof, such as lending and investment decisions and their effect on the economy and society. Product marketing should be executed with full disclosure of pertinent information - customers now expect transparency as an integral part of the institutional culture and business practices.

Due to the fact that trust is often a bank's most valuable – albeit intangible asset- its credibility and repute are the make-or-break factor in its sustainable success and pursuits therewith. Limited liability and legal protections cannot absolve companies in general, and banks in particular, from the ramifications of their actions.

Corporate ethical standards and beliefs are embodied and promulgated by employees. Front end staff translates business ethics policies into ethically considerate day-to-day operations and customer service. This renders training and development initiatives indispensible - inculcating the right values in employees is imperative. Moreover, incorporating behavior aligned with corporate culture and corporate ethics in performance appraisals and linking rewards to the realization of core values and ethical standards, in addition to performance, prove effective in infusing business ethics in human resource bodies.

Internal ethics pertain to the employee satisfaction and customer service quality, benefits and equality. In the short term, the more financially feasible and tempting cost efficiency should not take precedence over moral concern, asin the long run ethical compromises cripple even the most financially sound enterprises and institutions. Banks are increasingly embracing the realization that being ethically considerate institutions enhances the overall market confidence and paves the way for sustainable profitability and growth opportunities.

As with any change that we desire to institute in our respective organizations, ethical conduct and moral culture can only be nurtured and truly infused in the organization if the leadership exemplifies the same with their business and personal conduct. Codes and policies remain glorifying words on paper until they are practiced and communicated in a top-down flow of change.

In the quest to be ethically cognizant and compliant, organizations need to be abreast of and in compliance with regulatory directives; in addition to this, corporations also need to focus upon self-regulation, and accept ethical obligations with responsibility. Integrity and professionalism are not just elusive jargon any longer – they now present themselves as the minimum service standard.

Editorial *(January - March 2014)*

In the 1970s, inspired by the socialist economy, Pakistani government authorities undertook a redistribution of assets, from the private sector to the state. The collapse of the socialist model, and bankruptcy of the economies following the same, rendered the subject economic ideology outmoded. This paradigm change led to policy reforms and privatization initiatives being introduced by the government in 1991.

Now, in 2014, the re-instated Nawaz government once again aspires to embark on a fast-track ambitious program to bring in proceeds of Rs. 150 billion by end June 2014 through the privatization of several state-owned enterprises (SOEs) including: Pakistan Steel Mills (PSM), Faisalabad Electric Supply Company (FESCO) and Thermal Power Station (TPS) in Muzaffargarh (GENCO-III) and the national carrier Pakistan International Airline (PIA).

According to some, privatization of assets has not contributed to sustainable growth in the Country's GDP and employment. In an analysis of Pakistan's privatization drive in the '90s, dated 1998, the Asian Development Bank supports this claim by observing that 'only 22 per cent of the privatized units performed better than in the pre-privatization period; 44 per cent performed the same whereas approximately a third (34 per cent) performed worse.'

While privatization may be the necessary course of action in the case of some public enterprises, in other cases it has the potential to be detrimental to the society. Enterprises whose commercial promise is not proportionate to the significant role they play in the public's livelihood are better off in the control of the state. If private concerns were to the run the railway industry, for example, they would not find it feasible to run on routes in remote areas that do not generate much revenue.

A study of Pakistan's economy and commerce reveals that poor governance, and not ownership structure, has been the root cause of starring state-owned enterprise (SOE) failures. Governance quality is a critical success factor for both private and public enterprises. Poor governance can as easily bring a private concern down; it is only less evident and occurring in the private sector because profit-seeking private investors/stakeholders are more driven to supervise their organizations closely.

Many organizations contributing to China's long-sustained economic growth remain state-owned. The state-owned enterprises in Pakistan, too, have not always been generically categorized as loss making entities. PIA and Pakistan Railways have seen a prime where they were highly successful and renowned worldwide.

Privatization initiatives cannot be successful without preparation – the government should first ensure that the subject entity will be more productive and effective in the private sector. Privatization should be driven by the motive of enhancing efficacy of enterprises, not as a cash inflow faucet. Often times, SOE's take the hit due to the government's inability to tax the rich and generate resources; when 'not having enough resources' to sustain public enterprises is cited as a reason to privatize, fiscal indiscipline is the root problem and issue at hand – not public-private ownership.

Fiscal distress notwithstanding, the ailing up-for-sale public organizations require overhauls, restructuring and investment levels, the likes of which the government does not have resources to make. While nationalization was undertaken primarily so that the poor benefitted from state control over assets, the less-economically-privileged have in reality witnessed state corporations draining budgeted state resources; approximately

Rs. 500 billion is annually spent to keep public sector corporations, banks and other enterprises afloat.

The privatization initiative of Pakistan Steel Mills was stalled in 2006. Since then, the state has injected –and continues to inject - billions of Rupees into the loss-making entity. PTCL, on the other hand, has exhibited significant enhancement of operational efficiency since it was partially sold to Etisalat in 2005.

Free markets (if they can be called so despite being moderately regulated) are the optimal economic architecture for efficient allocation and utilization of resources. It is therefore argued that management of businesses and commerce should be left to private concerns. Doing so can markedly reduce corruption and generate sustainable and equitable growth in the country. Letting private enterprises, and investors, do their job can also dissuade nepotism and cut down the 'private profits' that often change hands to cut the bureaucratic red tape and oil cogs in the state machines.

The relative inefficiency of public enterprises stem from the fact that their respective managements do not have any direct personal incentives tying them to the business output. Comparatively, the performance - driven compensation structure of private sector organizations is theoretically and actually more productive and commercially viable.

The Pakistani banking sector is a good example of market-based competition, privatization and sound regulation having yielded industry-wide reformation during the last several years. The banking system proved its strength by withstanding the pressures emanating from the global financial crises and local economic challenges. Such a model should be replicated across the different sectors in the economy.

We have witnessed many a private organization fail, and be bailed out by governments, to know the vital role of governments in 'free-market' systems. We have also seen required investment I organizations being ignored due to depleted fiscal accounts.

Keeping both ends of state-involvement in consideration, the optimal role of the establishment appears to be: to provide a conducive business environment geared towards sustainable economic growth – while effecting socio-economic change through investment in human development and infrastructure. Beyond this the government should do what its name etymologically implies – 'govern' and regulate the market to ensure fair play and ethical practice of business.

Editorial *(April - June 2014)*

The end of Pakistan's fiscal year 2013-2014 found the economy posting a continued lackluster performance that remained stunted by the plaguing energy crisis, reduced flow of FDI, low revenue generation, mounting domestic debt and falling investment and savings. A dismal real GDP growth of 4.1% during FY14 remained below the target of 4.4%, climbing only slightly over the previous 3-year average of 3.7%. This economic growth featured as one of the lowest in the region.

The budget of FY15 was presented with an aggregate outlay of PKR 4.3 trillion –this total budget outlay is 8% higher compared to that of FY14. This ambitious budget envisages a relatively higher economic growth of 5.1% to be attained by attracting higher investment.

The paucity of foreign direct investment flows in the past few years had been a growing economic concern. However, revival of the same is on the horizon with estimations of FDI marking at approximately USD 1 billion in FY14. IMF's Extended Fund Facility (EFF) and other external foreign currency flows including the auction of 3G/4G licenses and floatation of bonds in the international market have contributed to the stabilization of PKR/USD exchange rate. As a measure to attract FDI, Budget FY15 has reduced corporate tax rate to 20% if the investment is in a new industrial undertaking or a construction or a housing project. The Budget anticipates forex reserves to increase to USD 22 billion by the end of the fiscal year.

All is not well in the other aspects of the external account. Trade deficit is emerging as a considerable concern, with total imports estimated to be around USD 41 billion in 2014, compared to total exports of USD 26 billion. Workers' remittances continue to provide cushion in the external account; the growth trajectory of remittances has significantly contributed in generating foreign exchange inflows.

Meanwhile, domestic debt has been spiraling upward and thereby exerting pressure on the domestic interest rates, in addition to crowding out the private sector investment. Public debt has witnessed a particular spike in April '14 due to the USD 2 billion raised through floating Euro Bonds at 7.25% &8.25% - rates that are considerably higher than of comparable bonds floated internationally.

The growth in domestic debt has caused higher inflation and a tightened monetary policy; interest rates have suffered an upward pressure which has further crowded out the private sector. Despite slow economic growth, the inflation rate exceeded its target and emerged as one of the highest inflationary pressures among the economies in the region. In another ambitious goal, Budget FY15 envisages containing the inflation within 8%.

Investment, which was targeted to stand at 15.1% in FY14, has continued to decline and has reduced from 19.3% of GDP in FY06 to the present state of 14% of GDP. Despite a tightened monetary and interest regime, the savings rate also remains low. As per budget FY15, investment to GDP ratio will be increased to 15.7% (targeted at 14% in budget FY14) and savings to GDP ratio is to be increased to 14.2% in FY15 (targeted at 12.9% in budget FY14).

Revenue generation in the form of taxation, the leading cause of high fiscal deficit, has remained under 10% of the GDP for the past few years, and is one of the lowest in the region. FY14 has witnessed a slight improvement in this aspect, with tax to GDP increasing marginally to 10.6%, which is only slightly lesser than the budgeted target of 10.9%. Fiscal deficit, too, has also been contained to 5.8% of GDP and is lower than budgetary target of 6.3%.

Budget FY15 has announced an aspiring FBR tax collection target of PKR 2,810 billion to enhance

Tax to GDP ratio to 11.5% by end of FY15 and contain the fiscal deficit at 4.9% of GDP. There is an urgent need of structural reforms in taxation as approximately 61% of the FBR's tax revenue during FY14 emanated from indirect taxation. Fundamental reforms would be more efficacious rather than the proposed taxation enhancement measures based on withholding taxes and other such changes.

According to estimates, the energy crisis has cost Pakistan's economy a hefty 2% every year. The vital, yet stagnant power and gas sectors, have registered a growth of 3.7% - which nonetheless is an improvement compared to the previous year's negative growth of 16.3%. In a positive development, the resolution of power sector's circular debt has resulted in alleviation of power shortages and has contributed to the growth in the industrial sector. Budget FY15 has proposed subsidies for power sector to be reduced to PKR 229 billion.

PSDP budget has been enhanced to PKR 525 billion, up from PKR 425 billion in the previous year, while aggregate expenditure for development projects (mostly comprising long term infrastructure projects by the Federal Government) is budgeted at PKR 839 billion.

Last but woefully not the least, education and health indicators remain bleak in the face of declining public expenditure by the provincial governments in these sectors. Cutting back on vital investments such as education, healthcare and development to fund stop-gap measures of fiscal deficit control reflects poor vision and policy. Pakistan ranks 164th out of 173 countries in terms of expenditure on education and the future of the nation deserves better than what budget FY15 has laid out for it.

On a concluding note, despite all the economic challenges detailed above, the foremost challenge that the Government will face in FY15 and the years to follow is: consistent policy design and efficient implementation.

Sustainable Economic Growth and Trade

The lackluster economic activity is indicating signs of rejuvenation in FY14; agriculture production will play a significant role in continuing economic stimulation in FY15, with the Large Scale Manufacturing (LSM) sector expected to continue being mired by prevailing energy issues and capacity constraints. The economy will also have to cope with lower domestic and international prices and slower exports growth prospects in the textile sector.

Trade deficit is a concern on the balance-of-payments front, along with declining private capital inflows and foreign direct investments – an area in which the issuance of dollar-denominated Eurobond/Sukuks can provide much-needed economic relief. The recent IMF Review meeting has resulted in the expectation of the realization of USD 1.1 billion payment in the first half of December 2014. This, in addition to the issuance of USD 500 million Sukuk bonds in this month, is expected to increase foreign exchange reserves to USD 15 billion.

International oil prices have demonstrated a decline; this trajectory revision has been awaited for long and heralds a fortuitous reduction in the imports bill – an occurrence that would have been excellent for the trade position had it not been for the ailing exports segment.

Our exports have been struggling and need to be revived in order to complement the positive developments of imports curtailment. Implementation of initiatives and policies to boost Pakistan's exports must be directed at product/service development and enhancement, as well as market optimization /expansion. Within product development, enhancing value addition of traditional exports through calculated investment, well-directed Research & Development and modern technology is of paramount importance. Talent/skill development through vocational education and dedicated institutions for counseling and training can also make a vast difference by attracting and harnessing a synergetic talent pool.

Stimulation of SMEs will go a long way in boosting economic activity. Financial focus and access to credit, when extended to small and medium enterprises, has proven to boost economic productivity, which can be reasonably expected to translate into greater export of products. China is an excellent case study of transformative economic growth being sustainably enjoyed through a dedicated focus on SMEs – a model that Bangladesh is keenly following.

With reference to exports market optimization and development, it is time to take stock of the demand realities of our traditional export markets such as US & EU, where slow growth in demand can be witnessed and further projected. It is therefore a natural choice to penetrate opportunities in Russia, Africa and Asian markets such as China and India.

Duty-free access to European markets, made possible by the GSP Plus status awarded to Pakistan earlier, boosted textile garment exports by approximately 31% within the first two months of the Status coming into effect. Trade concessions through the GSP Plus status will benefit the country's textile industry the most by providing it with competitive stamina against regional rivals Bangladesh and Sri Lanka, which already possess duty-free access to the European Union. Leather and carpet manufacturers have also benefited from the GSP Plus with an increasing share in the European market, and shipments growing by 15.20 percent & 12.79 percent in January & February 2014 alone.

As per projections, this trade preference scheme will continue to benefit our export flow of trade. The GSP Plus will result in almost 20 percent of Pakistan's exports entering the EU market at zero tariffs, in addition to 70 percent of the exports entering the subject market at preferential tariff rates. It is important to note, however, that preferential trade status and concessions, while being a great advantage without any doubt, should not give us any sense of complacency. Exports are not going to augment in any sustainable manner through preferential access. As mentioned before, sustainable development of our exports portfolio will come through superior products targeted at diverse and well-selected markets.

Editorial *(January - March 2015)*

The year 2014 was beset with myriad developments altering the Country's economic landscape. Inflationary pressures exhibited a deceleration - with major monetary indictors reflecting the falling trend of inflation. The reduction in oil prices and decelerating inflation also renew hope of improved competitiveness of Pakistani exports. Supplementing this is the expectation of augmentation in economic productivity as GDP growth is on course to surpass the FY14 outcome.

Fiscal deficit has been contained and efforts towards government borrowing curtailment have also been witnessed. This progress towards fiscal consolidation - and subsequent reduction in budgetary borrowing - along with the relaxed monetary stance adopted by the SBP, emerge as encouraging drivers of private sector credit growth. Meanwhile, constrained economic productivity, slower deposit growth faced by banks, challenging security situation, falling commodity prices, and continued energy shortages continue to pose challenges to private sector credit supply. Growth in credit to private sector during Jul-Feb FY15 has remained subdued at Rs 158.9 billion compared to Rs 298.3 billion in the same period of FY14.

Nonetheless, growth in private sector credit is expected to pick up pace as a result of the loosened monetary stance adopted by the SBP. Owing to recent foreign exchange inflows, decelerating import growth and strong workers' remittances, external sector outlook continues to improve as current account deficit has shrunk in in Jul – Feb period of FY15 as compared to same period last year. Falling international cotton prices and stiff competition in low value-added textiles are expected to exert more pressure on our struggling exports, in a global arena that is already plagued by weak demand. Meanwhile, foreign exchange inflows have contributed in maintaining an upward trajectory in foreign exchange reserves and stable currency parity.

CPI inflation touched a low of 4.3 percent in December 2014, and average CPI inflation during July-December 2014 marked at 6.1 percent, a deceleration that was driven by the plunging international oil price and decline in other global commodity prices. A broad based declining trend in inflation is expected in the near future as the outlook of inflationary pressures in the medium to long term remains contingent upon prices of commodities and oil. In alignment, the SBP has revised its projection of average CPI inflation downward to 4.5 – 5.5 percent for FY15, an estimate that is well below the initially assigned target of 8 percent.

The interbank market remained tight in H1-FY15, despite the relaxed monetary stance. Going forward, the realization of expected external inflows is likely to reduce the budgetary borrowing requirements from scheduled banks and improve liquidity conditions in money market. The banking sector closed the first quarter of 2015 with its deposits posting a growth of 12.38 percent year-on-year and amounting to Rs. 8.51 trillion; meanwhile, advances grew by 8.09 percent and stood at Rs. 4.43 trillion and investments grew by 26.68 percent to be recorded at Rs. 5.7 trillion. As of end of Dec'14, the sector's stock of NPLs had marked at Rs. 604.7 billion, and the infection ratio stood at 13.56%.

The SBP decided to reduce the policy rate by 50 basis points from 8.5 percent to 8.0 percent effective from end of March 2015. Going forward, the banking industry will need to strategize the generation of growth and profitability in the relaxed interest regime while businesses will be expected to utilize the favorable interest environment to mobilize sustainable enhancement in economic productivity. Revenue generation through broadening the tax net and reduction of tax evasion will also play in an important role by strengthening fiscal discipline. If the macroeconomic challenges, as detailed earlier are addressed, we see Pakistan's economy to be more robust in the remaining fiscal year.

Conduct Risk – The New Buzz Word in Banking Regulation

What is an organization's reputation worth?

The answer is simple: everything.

The results of a study by the World Economic Forum reveal that, on average, more than 25 percent of an organization's market value is a result of its reputation. An organization's reputation is what determines its success. When tarnished, it is also what determines organizational failures.

One of the greatest lessons that the banking industry learned from the global financial crises of 2008 is that reputational risk is as important as the more conventional banking risks such as market risk, credit risk, liquidity risk and operational risk. Post financial crises, reputation and conduct risks have emerged as high importance buzzwords on bankers' radars.

A reputation risk that is not timely and effectively managed can escalate into a major strategic crisis at an alarmingly fast pace. The cost of poor conduct is high; not just in terms of legal repercussions, but also in terms of the reputational erosion and the ensuing loss of business.

As a consequence of the many financial scandals that emerged during the financial crises, banking regulatory authorities introduced stringent preventative regulation, with particular focus on ethical aspects of banking service delivery and operations. This paradigm shift towards increased regulation is enhancing banking vigilance, controls and compliance. However, in some instances, stricter regulation alone does not remedially address the cause of improper, unethical conduct.

Simply put, this popular buzzword 'conduct risk' is the reputational risk that the organization faces from its staff acting unprofessionally, unethically or illegally. It refers to risks attached to the way in which an organization and its staff conduct themselves - 'behavior' is the most important element of conduct risk. Due to its complexity, conduct risk is not easily managed only by rules, policies and procedures.

Conduct risk emanates from ethically compromised corporate culture and unethical behavior of employees – behavior that could cause malfunctioning of soundly architected controls. The ethics of the individual and the culture within the organization are both significant influencers of an individual's conduct.

Conduct risk is manifest in different forms. Conduct risk can occur in the way clients are served and how well the responsibilities of making profit for one's client and generating profit/result for the organization are balanced. Another form of conduct risk is when employees engage in financial misdemeanors by assisting clients in acquiring financial assets that do not comply with the law. Conflict of interest is another form of misconduct where personal interests of employees are not in line with the organizational or public interests. Market abuse, which entails incidents of market manipulation and insider trading, is another form of conduct risk.

While it is very important to have the right rules and regulations in place, their efficacy is compromised if behavioral elements do not complement these compliance directives. This is why conduct risk needs to managed with caution, and requires that organizations gauge their ethical culture, with the right management inculcating the ethical culture down the corporate echelons, stimulating compliance awareness and improving the commitment to compliance goals. Organizations, therefore, need to lay emphasis upon behavioral aspects and be able to measure them in order to proactively improve compliance.

The process for mitigating conduct risk is more complex and difficult to define than those of the more technical risks that the financial sector faces. The managements of organizations need to evaluate the company's values and objectives in order to frame 'customer outcomes' that they need to deliver. Once these outcomes are defined, the management should ensure alignment of corporate strategy with these fair customer outcomes. The next step requires ensuring that organizational/ business processes are optimized to deliver fair outcomes to customers. This also means ensuring that a conducive culture is in place within the organization to facilitate employees to achieve the requisite results.

A 'right' corporate culture is one which puts customers and market integrity at the heart of the organization's business. This can be promoted by an ethically conscious management articulating its vision of ethical conduct into easily understood business practices, and implementing these within the organization. This should be followed by reinforcing desirable behaviors through performance management and rewards.

A management team that focuses upon organizational values while remaining committed to delivering fair value to customers can generate sustainable reputational benefits for the organization.

Editorial *(July - September 2015)*

Up till 2013, the SBP had kept its monetary policy tight; since then it has loosened the same by reducing the policy rate repeatedly. In doing so, it reduced the interest rate by 350 basis points between November 2014 and September 2015. In its most recent decision, the Regulator cut the policy rate down further by 50 basis points to 6 percent – a rate that stands at a 42 year low.

However, the effects of the loosened monetary stance have yet not transpired in the flow of credit to the private sector. The flow of credit increased by Rs 208.7 billion during FY15, compared to Rs 371.4 billion in FY14. This restricted flow of credit can be attributed primarily to dampened domestic and international demand, structural bottlenecks, low commodity prices and government borrowing from the banking system.

In contrast to FY14, when ample foreign inflows provided financing for the fiscal deficit, the government relied heavily on the banking system for its financing needs in FY15 when foreign inflows dried up. A record borrowing of Rs. 1,339 billion was conducted from the scheduled banks, with most of the funds being used to retire the SBP's debt. The expectations of monetary easing and the loosened monetary stance implemented by Regulator further facilitated the government in meeting its financing requirements.

Real lending rates have marked at around 4 percent since mid-FY15 due to declining inflation. Hence, while monetary conditions appear to have loosened, they still remain tight in real terms. However, the credit flow to the private sector is expected to pick up in the near future, with the expectation of increased productivity heralded by an increase in fixed investment loans by energy generation and distribution, chemicals and services sectors. Credit for long term investment purposes was recorded at an increased Rs. 126.9 billion in FY15 as opposed to Rs. 71.4 billion in FY14.

To be noted is the fact that excluding the exceptional credit demand in FY14, and when comparing with the average of the past 3 years' credit uptake of Rs113 billion, the credit directed to the private sector in FY15 does not seem to be on an actual declining trend.

As per projections, a lagged impact of the eased monetary stance of FY15 will be witnessed in the upcoming credit cycle of the first half of FY16. Higher credit utilization in construction and real estate sectors depict that going forward in 2016, these sectors are likely to exhibit increased productivity and credit demand. Agriculture credit, too, is expected to grow broadly as per its stable trend while the outlook in the textile sector remains lackluster due to the projections of low cotton prices in the medium term. The energy sector also holds promise depending on the early actualization of energy projects under China Pakistan Economic Corridor (CPEC).

Bolstered investor confidence as a result of positive IMF reviews, political stability, improved law and order situation and the prospects offered by the CPEC are further strengthening the expectations of an impending increase in flow of private sector credit.

Editorial *(October - December 2015)*

"*An organization is only as good as its people*." This adage has undergone much verbal wear and tear and only in recent times has the corporate world truly come to appreciate the truth behind these words.

In the past, organizations looked towards the mobilization of new business and curtailment of costs for boosting the bottom line; however, increasing evidence of the correlation of employee motivation/satisfaction and organizational productivity/financial performance is promoting cognizance of the financial fruits of a satisfied staff. Recent studies present findings that factors such as work environment, compensation, benefits, managerial competence and organizational vision drive employee satisfaction, which in turn yields customer satisfaction, heightened productivity, optimized performance and improved financial performance. In fact, it is not only the motivation of employees who directly interact with customers that translates into customer satisfaction; even employees who do not deal with customers directly contribute to overall customer satisfaction by enhancing the output quality and efficacy of the organization's offering to the customer.

Products and services are becoming increasingly replicative, with their shelf-life becoming shorter than ever before. Organizations are faced with the challenge of generating sustainable competitive advantage in the long-term, as they come to accept that they cannot continue to rely on innovation alone to deliver lasting value.

Organizations are starting to focus on retaining customers, and this mindset is now competing with the previously all-consuming focus on acquiring 'new' customers. It is becoming increasingly apparent that the loyalty of existing customers who stay with the organization continues to pay off over a more profitable long term and generates exceptional value - "lifetime value of a customer" can be exceedingly profitable.

There are several ways in which organizations can generate employee satisfaction that impacts customer satisfaction and yields more profitable returns. Firstly, the management of organizations should make a long-term commitment to employee engagement, along with clearly defined goals, as a core objective of the organization, in addition to consistent use of open and frequent lines of communication that invite the input of employees and demonstrate the value of the same by making changes based on it. Moreover, employee and organizational goals should be clearly defined and communicated, with well-designed and motivating reward & recognition systems.

Organizations should also dedicatedly focus upon training and development of employees at all levels so that they have the necessary skills to effectively and efficiently deliver upon their goals. The employees should be included in integrated marketing programs that are as directed towards channelizing energy of employees towards organizational goals internally, as they are towards broadcasting external brand communications.

This paradigm shift in the HR landscape not only heralds changes in interrelated functions such as corporate communication, business planning and rewards & recognition, but also calls for the introduction of specialized and targeted motivational programs.

Going forward, in order to augment profitability, organizations will enhance investment in their human resource base to further strengthen and motivate their employees into delivering upon superior customer service. This will, without doubt, be an interesting change in organizational management and should be one that the more pre-emptive and dynamic organizations can cash upon by embracing the concept at the earliest.

Editorial *(January - March 2016)*

Global events related to terrorism changed political and economic landscapes around the world. They also greatly impacted preventative measures for money-laundering and the financing of terrorism, which have since then climbed at a fast pace on political and regulatory agendas.

The responsibility for countering terrorism-related payments and preventing laundering has been majorly transferred to the financial industry. Regulators have partnered with financial institutions to combat money laundering and the obligation of banks has increased over the years in this regard. Financial institutions were initially only motivated to comply with regulatory directives pertaining to AML & CFT to avoid being penalized; however, over time, the financial industry has become acutely cognizant of the negative impact of money laundering on their reputation, brand image and subsequently on their bottom lines.

Financial intermediaries are abused when they are used for monetary concealment and laundering, and this makes them a significant stakeholder in anti-money laundering endeavors/initiatives. In order to safeguard their assets, banks and other financial institutions are engaged in an ever-ongoing fight to deter financial crime and frauds. Hence, it is of paramount importance for financial institutions to completely comprehend and implement measures and policies for identification and risk assessment of their customers.

The nature of this strenuous obligation requires participation from top to bottom – and from front-end to back-end – in financial institutions. This requires strong communication and exemplified focus from the top management, along with demonstration of commitment to the fight against AML & CFT through regular trainings of staff to ensure inclusive awareness of the subject and the institutions objectives in this regard. Employees must possess updated knowledge of regulatory requirements, policies and ramifications of all aspects of money laundering related to finance.

It is common for institutions to defer required AML & CFT actions, policies, communication and training programs till they receive coercive regulatory directives. However, institutions should take a more proactive stance and consider AML & CFT a reputation management issue rather than a host of regulatory requirements.

Institutions should invest in automated and integrated technological architecture and solutions that execute and monitor AML & CFT sanctions efficaciously while minimizing risk. Capturing relevant data is a core requirement; in addition to this, data quality, data integrity and continuous monitoring are other aspects that require increased focus. Consistency and accuracy of source data are of foremost importance in the AML & CFT mechanism. A cohesive risk-based approach in which analysis of AML & CFT screening results and data banks is incorporated in revision of procedures geared towards risk mitigation, ensures optimal leverage of anti-money laundering efforts.

The increased regulatory focus upon AML and CFT measures - and the pressure of obligations arising out of the same - is encouraging institutions to allocate significant resources for combatting this global dilemma. While financial institutions are re-evaluating their policies and procedures in this regard, they should also understand that implementing measures is not a static step. Financial institutions have to play a role of active assistance to regulators and related agencies for elimination of wrongful transactions. The fight against money laundering and the finance of terrorism will only be sustainably effective if the stakeholders engage in constantly evolving their frameworks against combatting this malaise.

Editorial *(April - June 2016)*

2015 was a rewarding year for the economy and the banking sector of Pakistan. While year-on-year inflation rose from 1.3 percent in September 2015 to 3.9 percent in March 2016, average inflation marked at 2.6 percent and the expected outlook of inflationary measures remains controlled. The upward movement in inflationary pressures depicts a boost in aggregate demand led by the improved security and energy situations.

As a result, a general increase in demand has been observed in the services sector, and this coupled with the lower interest rates, have driven an increase in the flow of credit to the private sector – a positive development that bodes well for economic growth in the near future. The large scale manufacturing sector grew by an improved 4.1 percent between July 2015 and January 2016.

The PKR/USD parity remained stable in spite of growth in oil and machinery imports, and declining exports. The exchange rate was supported by the continued augmentation in remittances and foreign direct investment; the external account was provided reprieve in the form of depressed oil prices. Moreover, contained expenditures and a promising increase in tax revenues enhanced fiscal discipline.

While weakened global trade activity constricted Pakistan's export demand, the headway made on the China Pakistan Economic Corridor (CPEC) front has revived bilateral economic prospects and paved way for sustained economic growth prospects. The CPEC will bring a promised $46 billion worth of Chinese investment to Pakistan, with $11 billion being utilized for infrastructure development and $35 billion being channeled into energy ventures, which are expected to spur growth of industrial zones. The Corridor will also facilitate Pakistan's trade with the Central Asian republics. The banking sector also remains poised to optimally capitalize upon the financial intermediation opportunities presented by the China Pakistan Economic Corridor.

Branchless banking is another aspect which holds significant potential for the financial sector in the near future. Digital finance will work towards the implementation of National Financial Inclusion Strategy (NFIS) - a roadmap to achieve financial inclusion goals. The National Financial Inclusion Strategy, which was launched last year, aims to achieve universal financial access, with a target of expanding formal financial access to at least 50 percent of adults and increasing SME lending of financial institutions. The NFIS currently focuses on promoting digital transaction accounts, increasing scale of payments, diversifying access points, improving capacity of financial service providers and increasing levels of financial awareness and capability.

The State Bank of Pakistan continues to promote the branchless banking segment while enhancing its framework and regulatory dynamics further. The Regulator and the PTA's more recent efforts towards the same include their directives on the inter-operability of the mobile banking industry participants including banks, mobile network operators and technology service providers. The recently introduced Third Party Service Provider (TPSP) model will offer optimal outreach and connectivity and provide banks and telecoms further access to each other's customers.

Formal transaction accounts open regulated access to a host of financial services including savings, payments, insurance and credit, which not only enable the masses to manage their finances better and become financially independent, but also benefit banks through financial penetration and growing customer base. The aggregate network of branchless banking agents reached almost 300,000 across Pakistan in December 2015.

The remaining half of 2016 and 2017 will be a period of interest as it will set the foundation of the growth trajectory for this new era of economic progress.

BOOKS AUTHORED BY

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