

Pakistan

May 2007

Pakistan Economic & Strategic Outlook

Things are looking up...

Global Investment House KSCC

Economic Research
Souk Al-Safat Bldg., 2nd Floor
PO. Box 28807 Safat
13149 Kuwait
Tel: (965) 240 0551
Fax: (965) 240 0661
Email: research@global.com.kw
<http://www.globalinv.net>

Global Investment House stock market indices can be accessed
from the Bloomberg page GLOH
and from Reuters Page GLOB

Omar M. El-Quqa, CFA
Executive Vice President
omar@global.com.kw
Phone No:(965) 2400551 Ext.104

Faisal Hasan, CFA
Head of Research
fhasan@global.com.kw
Phone No:(965) 2400551 Ext.304

Chandresh Bhatt
Senior Financial Analyst
cbhatt@global.com.kw
Phone No:(965) 2400551 Ext 270

Dr. Sandeep Gupta
Financial Analyst
sgupta@global.com.kw
Phone No:(965) 2400551 Ext.504

Burhan Ali
Financial Analyst
bali@global.com.kw
Phone No:(965) 2400551 Ext.229

Table of Contents

Summary -----	1
Annual Indicators -----	4
Economic News flow -----	5
Macroeconomic Profile -----	7
Gross Domestic Product-----	9
Public Finance-----	11
Public Debt-----	13
External Trade-----	16
Current Account-----	19
Capital and Financial Account-----	20
Monetary Policy-----	22
Inflation-----	27
Population and Demographics-----	28
Structural Reforms-----	30
Taxes -----	32
Privatization-----	34
Sectors Performance	
Agriculture -----	36
Manufacturing-----	39
Banking-----	43
Energy-----	51
Wholesale & Retail Trade-----	54
Auto & Transport-----	56
Housing & Cement-----	60
Stock Market and Bond Market	
Karachi Stock Exchange-----	63
Bond Market-----	70

Summary

Pakistan is located in South Asia and the Greater Middle East. It is bordered by Afghanistan and Iran in West, India in East and China in North-East. Modern day Pakistan consists of four major parts called provinces namely- Punjab, Sindh, Balochistan and North West Frontier Province.

Pakistan's real GDP grew at a CAGR of 6.8% from US\$62.4bn in 2002 to US\$82.1bn in 2006. On year-on-year basis however preliminary figures point out that real GDP grew at a slower rate in the year 2006 (6.6%) compared to 2005 (8.6%). Slower growth (as expected, following a cyclical peak in the previous year) was the result of reduced contributions to GDP growth from agriculture and industry. Besides this damage due to earthquake (US\$2.3bn as assessed by World Bank and Asian Development Bank) was the other cause of slowdown in growth. Nominal GDP stood at around US\$129bn in 2006 and grew at 16.2% compared to GDP of US\$111bn and growth rate of 13.1% in 2005. The acceleration in GDP growth in 2005 as compared to that in 2004 is attributed to the structural reforms and privatization by the Pakistani government. In the same line, Pakistan's per capita GDP has increased from around US\$712 in 2005 to US\$845 in 2006.

The country's economy is largely made up by agriculture (21.6% of GDP), manufacturing (18.2% of GDP) and wholesale & retail trade (19.2% of GDP), as together they account for about 60% of GDP. Services sector, make about 42.9% of Pakistan's GDP. Major sub-sectors are trading, transport and financial services. Financial services accounted for 4.6% of GDP while transport & communication accounted for about 10% of GDP in FY06.

During FY06 services sector grew at much better rate (8.8%) as compared to commodity producing sectors (4.3%). Among the services sector finance & insurance grew very rapidly at 23% followed by wholesale & retail trade, which grew at 9.9%. Among the commodity producing sectors, manufacturing grew well at 8.6%. In the coming years, manufacturing, trading, finance and auto sectors are likely to be the star performers in the economy of Pakistan.

Pakistan had an external debt of about 28% of GDP (at Jun-06). However, it has been consistently decreasing for last few years and has come down from about 47% of GDP in Jun-02 to 28% of GDP in Jun-06. The government has been rolling over loan of US\$1,300mn for last few years. Its public debt was about 57.3% of GDP as at Jun-06.

Pakistan's budget deficit (including grants and earthquakes) has gone up in the last three years from US\$1.1bn in 2003 to US\$3.6bn in 2006. Despite increase in revenue from taxes the budget deficit has gone up, the main reason for this has been increase primary and capital expenditure (up by 59.8% during the three year period of 2003-2006).

Taxes, which made about 77% of the revenue in 2003, accounted for about 74.7% of the government revenue in 2006. However, tax revenue has increased by 45.1% during the same period. This is a good sign for the government overall as it suggests increase in Pakistani corporate's and general people income.

Pakistan trade deficit has risen from US\$294mn in FY02 to US\$8,464mn in FY06. Pakistan is likely to see a further rise in trade deficit further in FY07. The figures for first seven month are reported to be US\$6,106mn. The reason for such rise is faster increase in imports as compared to that in exports. During the period of 2002-06 exports grew at CAGR of 16%, while import grew at CAGR of 27.6%. On Y-o-Y basis exports rose by 14.3%, while imports rose by 31.7% during FY06. The phenomenon is typical of rapidly growing economy where due to increased disposable income demand for external goods and services far outpace the exports. Nevertheless, Pakistan has had many positive developments in trade arena, which is likely to boost its trade further in coming years: The country has had the Agreement on South Asian Free Trade Area (SAFTA); Free Trade Agreement (FTA) with China; FTA with Sri Lanka.

Pakistan witnessed significant dip in the current account balance in FY06, and registered a deficit of US\$5,015mn against deficit of US\$1,534mn in FY05. This dip came on the back of a 87.5% y-o-y increase in trade deficit (due to sharper increase in imports than that in exports) and 24.2% increase in debit for services in FY05. Current account deficit was kept in check by the transfer, which grew by 21.6% on Y-o-Y basis. The overall effect was- current account deficit increased from -1.4% of GDP in FY05 to -3.9% of GDP in FY06. The reason for increased imports has been increase in disposable income of Pakistani people leading to increased demand of goods, and increased imports of machinery which we believe is a positive sign for the economy of Pakistan. The balance of payment has been held by growth in Capital & Financial account. The Capital and Financial account has been in surplus for last two years and it had seen big surge in FY06 to US\$6,096mn on the back of increased FDI and portfolio investment. Surplus in Capital and Financial account helped to keep overall balance on positive side in FY06.

The account is likely to show more surplus in FY07 on the back of increased FDI (up by more than 68% in first seven months of FY07 on Y-o-Y basis) and increased net portfolio investments on the back of rapidly growing economy of Pakistan.

Pakistan total forex reserves has grown at healthy pace of 19.5% in last four years as a result of growing economy and increasing FDI and portfolio investments. Net Reserves with State Bank of Pakistan (SBP) has grown at much better rate, CAGR of 25.5% as compared to net reserves with commercial banks, which grew at CAGR of 3.2% during FY02 to FY06. Despite a healthy increase in forex reserves, reserves in terms of months of imports fell from a high of 11.3 months of imports in FY03 to 6.4 months of imports in FY06. The reason for this fall is high growth in imports which grew by 117% in last three years (CAGR of 29.5%).

Money supply for Pakistan has been increasing consistently; this coupled with consistently high money velocity (more than 2.2 for last three years) has been the precursor of high inflation in Pakistan for last few years. However, the inflation rate in FY2006 as measured by the percentage change in the Consumer Price Index (CPI) dipped to 7.9% from 9.3% in FY2005. The reason for fall in CPI was tight monetary policy adopted by SBP such as raising the cash reserve requirement for banks and then increasing its main policy rate, the SBP three day Repo rate by 50 bps to 9.5% in Jul-06.

Pakistan's population grew at a CAGR of 2.1% during the four year period from 2002 to 2006, while GDP per capita grew at a CAGR of 18.1% during the same period. Pakistan had low unemployment rate in 1990s (less than 5%), but it shot up to about 8% in 2000. However, as a result of growing economy unemployment rate in has dropped from 7.8% in 2002 to 6.5% in 2006. Agriculture sector provides maximum employment to Pakistani people (43.4%), manufacturing and Trading together provides jobs to 28.5% of the people employed in Pakistan.

Stock markets and bond markets in Pakistan are in developing stage. Karachi Stock Exchange (KSE) has low Market cap/GDP ratio (about 35%) However, Pakistan is moving in the right direction as shown by strong rules and regulation, increasing market capitalization and listed capital and healthy liquidity in the market.

Similarly bonds market in Pakistan is also in early growing phase (5.9% of GDP) as compared to countries like Malaysia (93.2% of GDP). Korea (83.1% of GDP) and Singapore (71.5% of GDP). However, outlook for Pakistan bond market is positive and optimistic as economy is doing very well. In addition, secondary market is developing well in Pakistan so is the primary market. Moreover, issue of benchmarking is resolved to a certain extent with successful issuance of sovereign bond in year 2004. In light of this we opine that Pakistan bond market should do well in coming years.

In last few years Pakistan has taken several measures in shape of structural reforms, which have helped it boost its economy, increase its forex reserves and curtail the public sector enterprises (PSE) losses. Main one out of them are - deepening domestic financial markets, improving public service delivery, trade liberalization. We believe Pakistan economy is likely to grow well in coming years and Pakistan would continue to attract investments from foreign countries, which would further boost its economy.

Annual Indicators

	2002	2003	2004	2005	2006
Economic Performance					
Nominal GDP (US\$ bn)	71.9	82.6	98.1	111.0	129.0
Nominal GDP Growth Rate (%)	NA	14.9	18.7	13.1	16.2
Real GDP growth (%)	3.1	4.7	7.5	8.6	6.6
Per Capita GDP (US\$)	434	509	617	712	845
Growth in Per Capita GDP (%)	NA	17.3	21.2	15.5	18.6
Inflation					
CPI (%)	3.5	3.1	4.6	9.3	7.9
GDP Deflator (%)	NA	9.7	10.4	4.1	9.0
Public Finance (US\$ bn)					
(1) Total Revenue & Grants	11.8	14.5	14.2	15.4	18.6
Tax Revenue	8.0	9.6	10.5	11.0	13.4
Non-Tax Revenue	2.4	2.9	3.1	4.0	4.5
(2) Total Expenditure	13.8	15.4	16.4	20.0	23.6
Current Expenditure	11.7	13.9	13.3	15.8	18.2
Capital Expenditure & Lending	2.1	1.5	3.1	4.2	5.5
(3) Statistical Discrepancy	(0.2)	0.2	(0.6)	(1.3)	(1.4)
Primary balance {(1)-(2)-(3)}	(1.8)	(1.1)	(1.7)	(3.3)	(3.6)
Public Debt (US\$ mn)					
Total Debt	63,017	66,124	67,934	70,123	73,891
Total Debt % of GDP	87.6	80.1	69.2	63.2	57.3
External Debt	33,400	33,352	33,307	34,037	35,679
External Debt % of GDP	46.5	40.4	34.0	30.7	27.7
Current Account (US\$ mn)					
A. Good & Services (Net)	(592)	(370)	(2,595)	(7,807)	(12,896)
B. Income (Net)	(2,319)	(2,211)	(2,207)	(2,386)	(2,667)
C. Transfer (Net)	5,744	6,642	6,613	8,659	10,548
Current Account Balance(A+B+C)	2,833	4,061	1,811	(1,534)	(5,015)
Current account balance (% of GDP)	3.9	4.9	1.8	-1.4	-3.9
Money Supply (US\$ bn)					
Currency in Circulation	NA	NA	9.9	11.2	12.3
M2	NA	NA	42.8	49.7	56.8
Exchange Rate - PKR to US\$(end of the FY)	0.016658	0.017292	0.017199	0.01675	0.01662
Stock Market Indicators					
KSE-100 Index (December of the year)	2,701.4	4,471.6	6,218.4	9,556.6	10,040.5
Change in KSE-100 Index in % (Y-o-Y)	112.2	65.5	39.1	53.7	5.1
Listed Companies (as at year end)	NA	701	661	661	651
Market Capitalization (US\$ bn)	NA	16.5	29.6	46.0	46.0
Market Cap/GDP	NA	19.7%	30.6%	41.7%	35.9%
Value Traded (US\$ bn)	NA	66.4	83.6	120.1	144.7
Volume Traded (in mn)	NA	76,380.1	85,640.0	91,449.7	63,046.5
Turnover Ratio (X)	NA	4.0	3.4	3.5	3.1

Source: State Bank of Pakistan (SBP), Karachi Stock Exchange, IMF, Ozforex

FY: 1 July to 30 June

Economic News Flow (August 2006 to April 2007)

- Pakistan plans to serve as a communication hub as President Musharraf performed the ground-breaking of a US\$400mn modern airport project; it could prove a step forward to turn Pakistan into a major regional hub for trade, tourism and communication. (Source: Business Recorder; April-07)
- The weekly Sensitive Price Indicator (SPI) for the week ending April 5, 2007 Year-on-Year (YoY) increased by 7.84% as compared to the corresponding week of last year, showing a sharp decline of 8.9%. After many weeks of high inflation i.e. more than 8% increase since many months, the SPI has come down, below 8% year-on-year. (Source: Business Recorder; April-07)
- President General Musharraf stressed the need for initiation of negotiations for a Free Trade Agreement (FTA) between Pakistan and the United States to strengthen the bilateral relations by boosting trade and investment links. (Source: Business Recorder; April-07)
- Pakistan and Ireland's trade bodies have agreed for more systematic business promotional activities in trade between the two countries. In this regard a Memorandum of Understanding (MoU) was signed on April 4, 2007 by Zubair F Tufail, Vice President of the Federation of Pakistan Chambers of Commerce and Industry (FPCCI). (Source: Business Recorder; April-07)
- The Prime Minister of Pakistan emphasized the need for early finalization of Iran-Pakistan-India (IPI) gas pipeline on terms and conditions feasible for all parties. (Source: Pak Tribune; Jan-07)
- Trade between India and Pakistan could increase manifold, to US\$6.6bn, if barriers are removed and Pakistan implements the requirements of the South Asia Free Trade Area (SAFTA) agreement, says an Indian Council for Research on International Economic Relations (ICRIER) report. "Trade between the two nations is very small as compared to trade between India and its other large partners in South Asia," adds the report titled 'India-Pakistan trade'. However, informal trade through a third country is estimated to be around US\$2bn. (Source: Centre for Trade and Development; Dec-06)
- China and Pakistan have signed a free trade agreement aimed at tripling trade to US\$15bn in the next five years. (Source: China Knowledge; Nov-06)
- Adviser to the Prime Minister on Finance Salman Shah said that the energy sector was growing at a much quicker rate than the economy, which is growing at 7%. He added that the government was working towards the implementation of a comprehensive energy plan by 2030. (Source: Daily Times; Aug-06)
- Chairman Senate Muhammad Mian Soomro has urged upon members of Rice Exporters Association of Pakistan (REAP) to work jointly with growers, millers, exporters and all other stakeholders to meet rice export target set for year 2010. He

was speaking to REAP members at a ceremony held to celebrate US\$1.1bn export mark during fiscal 2005-06 (Source: The News, Aug-06)

- Minister for Tourism Nilofar Bakhtiar said the government was making all out efforts to make the country an attractive destination for foreign tourists and also promote domestic tourism. The minister said a tourism marketing strategy, focused on historical and cultural sites of international significance in Pakistan, was being followed. (Source: Business Recorder; Aug-06)
- Britain has become second largest investing country in Pakistan as 70 UK companies are investing in country's mega projects including modernising Pakistan Railways. Moreover, the bilateral trade between Pakistan and United Kingdom has crossed over US\$2bn mark. The UK is also the largest country in terms of remittances to Pakistan. In 2006 the total inflow of foreign investment in Pakistan was around US\$3.5bn which shows a great confidence of foreign investors in government's economic policies and peaceful environment for investment. (Source: Business Recorder; Aug-06)
- The government is to set up 100 technical education and vocational training institutions on fast track basis to supplement the National Vocational and Technical Education Commission's (NAVTEC) comprehensive programme to produce one million appropriately skilled work-force annually by 2010. This initiative would also help the government to meet the requirements of the skilled workforce of the export-oriented industries, which are at present facing an acute shortage of skilled workers to enhance production of exportable products. (Source: Daily Times, Aug-06)
- Emaar Pakistan, the country-arm of global real estate major Emaar Properties, has rolled out its first master-planned community in Pakistan, the Canyon Views. A mixed-use development integrating residential, commercial, leisure and retail components, «Canyon Views is the first of three projects of development value PKR145bn (US\$2.4bn) announced by Emaar in the country,» as told by the Managing Director, Emaar Pakistan. Emaar is also developing the highlands in Islamabad and Crescent Bay in Karachi apart from having signed a Memorandum of Understanding with the Port Qasim Authority to develop a mixed-use project in Karachi. (Source: Business Recorder; Aug-06)

Macroeconomic Profile

Pakistan is becoming more and more competitive and liberal market regime with the reforms implemented by the current government under the supervision of IMF. However, Pakistani economy is based on commodity producing sectors such as- agriculture, manufacturing, mining etc. together they make about 47% of GDP (as in FY06). Services sector accounted for about 43% of GDP. Finance sector makes a small contribution of only 4.6% of GDP. This is a sign of an economy that is yet to mature and as Pakistani economy matures we expect share of services sectors to go up in the economy in years to come.

The government of Pakistan has made significant macroeconomic reforms in last five years, most notable of them is privatizing the banking sector. However, inflation remains one of the biggest threats to the economy, which jumped to 9.3% in FY05 before easing to 7.9% in FY06. Increasing money supply for Pakistan coupled with consistently high money velocity (more than 2.2 for last three years) has been the precursor of high inflation. As per the latest information available (Apr-07) with SBP, M1 has increased by 934% on Y-o-Y basis to reach US\$23.6bn and M2 has increased by 39% on Y-o-Y basis to reach US\$6.5bn.

The central bank is pursuing tighter monetary policy raising interest rates in 2006, while trying to preserve economic growth. As lending rates have risen much faster as compared to deposit rates in last two years spread has increased from 3.6% in CY2004 to 7.4% in CY2006.

Pakistan accumulated significant amount of debt during 1990s due to its chronically bad balance of payment condition. In FY01 its total debt was about 93% of GDP, which continually came down every year since then and it stood at about 57.3% of GDP in FY06. Similarly, debt service by the government has consistently gone down from US\$6.3bn (2003) to US\$3.1bn (2006). As percentage of GDP too it has fallen from about 8% to less than 2.5% during the period 2003 to 2006.

Economic performance of Pakistan has been impressive for last few years as its GDP has grown at the CAGR of about 15.7% in nominal term and about 7% in real term during the period of FY02 to FY06. The growth has come mainly from manufacturing, construction, wholesale and retail trade and finance sector. As a result per capita GDP has nearly doubled from US\$434 in FY02 to US\$845 in FY06. Unemployment was estimated at 7.8% in 2002, it came down to 6.5% in 2006.

Fiscal deficit for Pakistan has doubled from US\$1.8bn in FY02 to US\$3.6bn in FY06 on the back of rising expenditure from US\$13.8bn in FY02 to US\$23.6bn in FY06. Pakistan's current account balance turned negative from a surplus of US\$2,833mn in FY02 to a deficit of US\$5,015mn in FY06, mainly on account of rising trade deficit from US\$294mn in FY02 to US\$8,464mn in FY06.

The government of Pakistan is keen on opening of economy and has taken several measures to promote trade with Asia and rest of world. It signed SAFTA in 2004, under which the first round of customs duty reduction took place, as agreed by the Member

States, in July/August 2006. It signed FTA with China in 2006 and FTA with Sri Lanka in 2005. These free trade agreement would give Pakistan better access to these two Asian markets and increase its exports.

To finance its increasing expenditure, the government of Pakistan has been trying to increase its revenue in form of tax collection. To achieve this, there has been progress on rolling out large- and medium-taxpayer offices, and advancing the functional integration of income and sales tax administration.

In addition, the government is focusing on deepening domestic financial markets as efficient financial intermediation would be a key element in the strategy to maintain Pakistan on a high-growth path.

The nation has low literacy rate of about 54% (as in year 2006), which means Pakistan needs to pay attention to this part of its development in order to have skilled labor force and more economically productive people. Pakistan's population is 165.8mn as in year 2006. It consists of mainly young people; 41% of people are less than 15 years and 34% of the people are 10 years to 24 years of age. This leaves potential for increasing demand in housing and increased participation in labor market by Pakistani people.

To reduce its debt burden and to alleviate poverty the government is putting thrust on privatization. The government envisage to allocate 90% of net privatisation proceeds to debt retirement and 10% to poverty alleviation programs. During FY06 the Privatization Commission has successfully completed seven transactions, which include privatisation of 26% shares of Pakistan Telecommunication Company Limited, 73% shares of KESC, 85.3% shares of Mustehkam Cement. During the period from July 2006 to December, 2006, the Commission has successfully completed privatisation of five transactions amounting to US\$1.1bn and as per the latest data available government of Pakistan had completed or approved 163 transactions valued at gross sale price of US\$7.1bn.

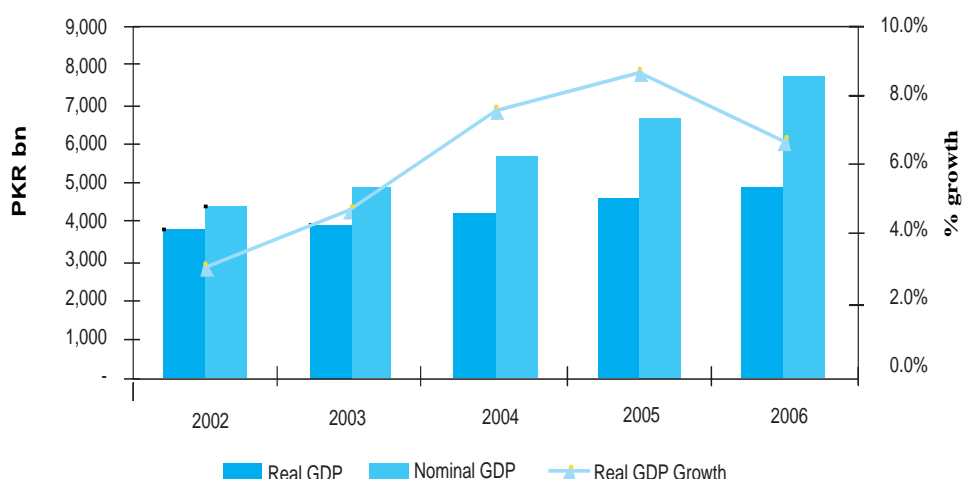
As a result of its liberalizing economy, Pakistan is attracting increasing FDI. It received US\$3.5bn in FY06 (up by 131.1% Y-o-Y basis). In FY07, first six months have been good with inflow of US\$2.1bn (up by 68.4% Y-o-Y basis). USA, UK and UAE make a major percentage of investment in Pakistan (about 62% of total FDI in FY07). UAE has emerged as major investor with its investments making more than 40% of FDI to Pakistan in FY06.

Reflecting the liberal economy and improving investment environment stock market in Pakistan has shown rapid growth in last few years. Value and volume traded on bourses have improved significantly over last few years reflecting the increasing liquidity in the market and market cap/GDP ratio too have improved reflecting the improving penetration of the market.

Gross Domestic Product

Pakistan’s real GDP grew at a CAGR of 6.8% from US\$62.4bn in 2002 to US\$82.1bn in 2006. On year-on-year basis however preliminary figures point out that real GDP grew at a slower rate in the year 2006 (6.6%) compared to 2005 (8.6%). Slower growth (as expected, following a cyclical peak in the previous year) was the result of reduced contributions to GDP growth from agriculture and industry.

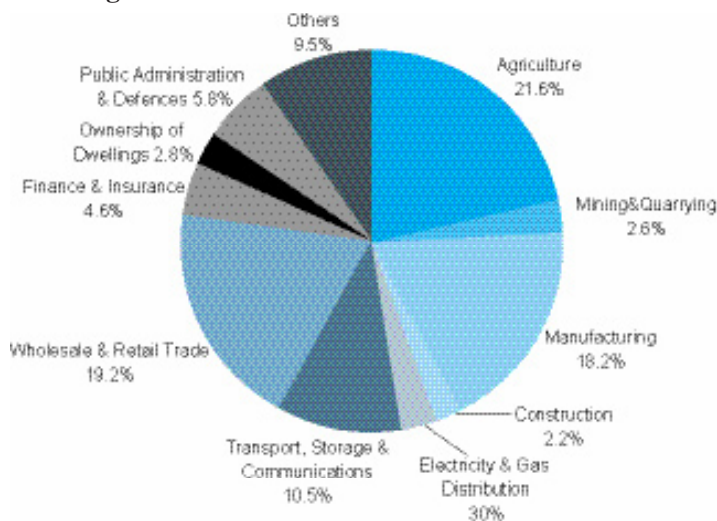
Figure 01: Pakistan’s GDP Growth



Source: SBP & IMF

Nominal GDP stood at around US\$129bn in 2006 and grew at 16.2% compared to GDP of US\$111bn and growth rate of 13.1% in 2005. The acceleration in GDP growth in 2005 as compared to that in 2004 is attributed to the structural reforms and privatization by the Pakistani government. In the same line, Pakistan’s per capita GDP has increased from around US\$712 in 2005 to US\$845 in 2006.

Figure 02: Percentage Share of sectors in GDP



Source: SBP

It is the commodity producing sectors, which make better part of GDP (47.6%); out of this agriculture contributes 21.6% and industrial (about 26%). Services sector, make about 42.9% of Pakistan's GDP. Major sub-sectors are trading, transport and financial services.

Table 01: Growth Performance of Components of GDP (% growth at constant costs)

	1990s	2003	2004	2005	2006
Commodity Producing Sector	4.6	4.3	9.2	9.2	4.3
Agriculture	4.4	4.3	2.3	6.7	2.5
Mining & Quarrying	2.7	6.6	15.6	9.6	3.8
Manufacturing	4.8	6.9	14.0	12.6	8.6
Construction	2.6	4.0	-10.7	18.6	9.2
Electricity & Gas Distribution	7.4	-11.7	56.8	3.5	-8.4
Services Sector	4.6	5.2	5.9	8.0	8.8
Transport, Storage & Communications	5.1	4.3	3.5	3.6	7.2
Wholesale & Retail Trade	3.7	5.9	8.4	11.1	9.9
Finance & Insurance	5.8	-1.3	9.0	29.7	23.0
Ownership of Dwellings	5.3	3.3	3.5	3.5	3.5
Public Administration & Defences	2.8	7.7	3.2	0.6	4.7
GDP (Constant Cost)	4.6	4.7	7.5	8.6	6.6

Source: Ministry of Finance

In real terms, commodity producing sector have grown at CAGR of 6.7% during 2003 to 2006. While services sector has grown at CAGR of 7% p.a. Whole GDP has grown at CAGR of 6.8%.

Pakistan's population grew at a CAGR of 2.1% during the four year period from 2002 to 2006, while GDP per capita grew at a CAGR of 18.1% during the same period. Going forward, we expect GDP for 2007 to show high growth as in recent past because of growing economy worldwide.

Public Finance

The general budget of the central government of Pakistan has been going deeper into deficit for last three years. The budget deficit (including grants and earthquakes) has gone up in the last three years from US\$1.1bn in 2003 to US\$3.6bn in 2006. Despite increase in revenue from taxes the budget deficit has gone up, the main reason for this has been increasing primary and capital expenditure (up by 59.8% during the three year period of 2003-2006).

Taxes, which made about 77% of the revenue in 2003, accounted for about 74.7% of the government revenue in 2006. However, tax revenue has increased by 45.1% during the same period. This is a good sign for the government overall as it suggests increase in Pakistani corporate's and general people income.

Table 02: Central Government Primary Balance

Figures in US\$ bn	2002	2003	2004	2005	2006*
(1) Revenue and grants	11.8	14.5	14.2	15.4	18.6
Revenue	10.4	12.4	13.7	15.1	17.9
Tax Revenue	8.0	9.6	10.5	11.0	13.4
Non-Tax Revenue	2.4	2.9	3.1	4.0	4.5
Grants	1.4	2.1	0.5	0.3	0.7
(2) Expenditure	13.8	15.4	16.4	20.0	23.6
Current primary expenditure	11.7	13.9	13.3	15.8	18.2
Capital expenditure & Net Lending	2.1	1.5	3.1	4.2	5.5
Public Sector Development	2.1	2.2	2.8	3.8	5.4
Federal	1.6	1.6	1.8	2.3	3.1
Provincial	0.5	0.7	1.0	1.5	2.3
Net Lending	0.0	-0.7	0.3	0.4	0.0
(3) Statistical Discrepancy	-0.2	0.2	-0.6	-1.3	-1.4
Primary balance {(1)-(2)-(3)}	-1.8	-1.1	-1.7	-3.3	-3.6
Primary balance (excluding grants & earthquakes)	-3.2	-3.2	-2.2	-3.6	-4.3
Primary balance (% of GDP)	2.0	2.9	1.7	0.2	-0.6

Source: IMF (Pakistani Authorities)

*Estimates by IMF

Most of the government expenditure goes to meet the current expenditure demands (90.1% in 2003 to 76.9% in 2006). Rest is made by capital expenditure i.e. capital expenditure made over 20% of the government expenditure in 2006 (up from less than 10% in 2003). This augurs well for future of Pakistani economy as fruit of this capital expenditure would show in years to come.

Table 03: Pakistan: Overall Fiscal Deficit and Financing

Figures in US\$ bn	2002	2003	2004	2005	2006*
Primary balance (excluding grants & earthquakes)	-3.2	-3.2	-2.2	-3.6	-4.3
One-off expenditure (earthquake-related spending in 2005–07)	0.9	0.0	0.0	0.0	1.1
Overall balance (excluding grants)	-4.0	-3.2	-2.2	-3.6	-5.4
Overall balance (including grants)	-2.6	-1.1	-1.7	-3.3	-4.7
Financing	2.6	1.1	1.7	3.3	4.7
External	0.9	-0.4	-0.6	1.9	3.4
Domestic	1.8	1.5	2.3	1.4	1.3
Bank	1.1	-1.0	1.1	1.2	1.2
Non-bank	0.53	2.46	1.05	-0.07	0.13
Privatization Receipts	0.13	0.07	0.19	0.27	0.00

Source: IMF (Pakistani authorities; and Fund staff estimates)

* Estimates by IMF

Fiscal deficit is expected to rise in FY2007...

The fiscal deficit has been increasing for Pakistan. The driving factor behind this has been increasing primary and capital expenditure, which is likely to go up in line with the government policy of developing public sector and investing more. However, despite increasing fiscal deficit, Pakistan is likely to grow at good pace considering the growth in manufacturing and capital expenditure that the government has made which will boost the manufacturing and other economic activities further. In addition, good economic condition worldwide would help Pakistani economy to do better.

Public Debt

The external debt is one of problems that Pakistan currently faces. More than 50% of its public debt is made by the external debt. It had an external debt of about 28% of GDP (at Jun-06). However, it has been consistently decreasing for last few years; figure has come down from about 47% of GDP in Jun-02 to 28% of GDP in Jun-06. The government has been rolling over loan of US\$1,300mn for last few years. Its public debt was about 57.3% of GDP as at Jun-06.

Table 04: Public Debt

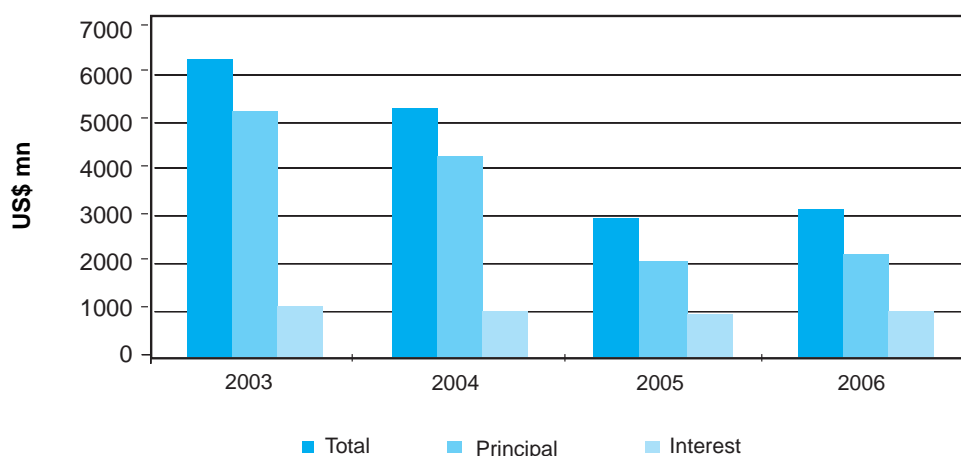
Figures in US\$ mn	FY02	FY03	FY04	FY05	FY06
Total Debt	63,017	66,124	67,934	70,123	73,891.2
External Debt					
1. Public and Publically Guaranteed debt	29,235	29,232	29,875	31,084	32,603
A. Medium and long term(>1 year)	29,052	29,045	29,853	30,813	32,407
Paris club	12,516	12,607	13,558	13,014	12,831
Multilateral	14,331	14,950	14,349	15,358	16,527
Other bilateral	429	512	720	805	847
Euro bonds/Saindak Bonds	643	482	824	1,266	1,908
Military debt	819	263	204	188	130
Commercial Loans/credits	314	231	198	182	165
B. Short Term (<1 year)	183	187	22	271	196
IDB	183	187	22	271	196
2. Private Non guaranteed Debts (M&LT:>1 yr)	2,226	2,028	1,670	1,342	1,585
3. IMF	1,939	2,092	1,762	1,611	1,491
Total External Debt (1 through 3)	33,400	33,352	33,307	34,037	35,679
4. Foreign Exchange Liabilities*	3,132	2,122	1,951	1,797	1,586
Total External Liabilities (1 through 4)*	36,532	35,474	35,258	35,834	37,265
Official Liquid Reserves	4,337	9,529	10,564	9,805	10,765

*Excluding FEBCs/FCBCs & DBCs from 30/06/99

Source: SBP

Total external debt was held constant in the range of US\$33.3bn to US\$34.0bn during FY02-FY05. It increased by 4.8% on Y-o-Y basis during FY 2006. Total external liabilities increased by 4% on Y-o-Y Basis during FY 2006, while official liquid reserves increased by 9.8% during the year. Increasing liquidity is a sign of comfort for Pakistani government in the wake of increasing external debt.

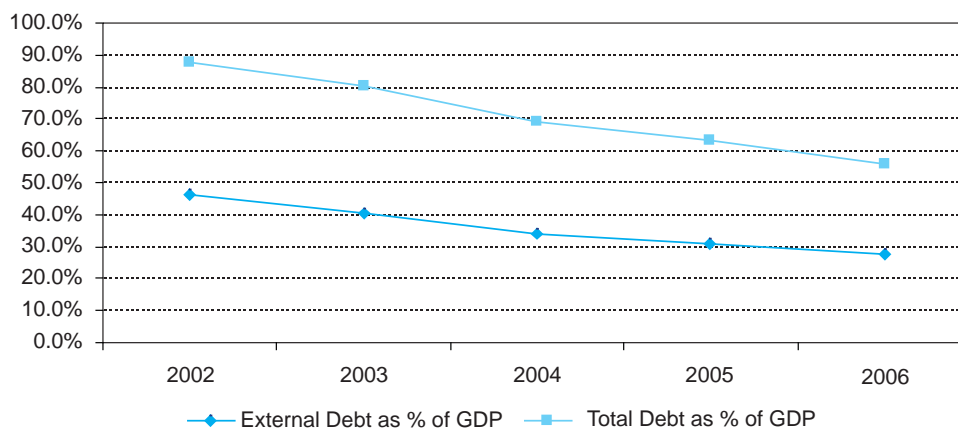
Debt service by the government has consistently gone down from US\$6.3bn (2003) to US\$3.1bn (2006). As percentage of GDP too it has fallen from 7.7% to 2.4% during the period 2003 to 2006.

Figure 03: Debt servicing by the Government

Source: SBP

Debt in check...

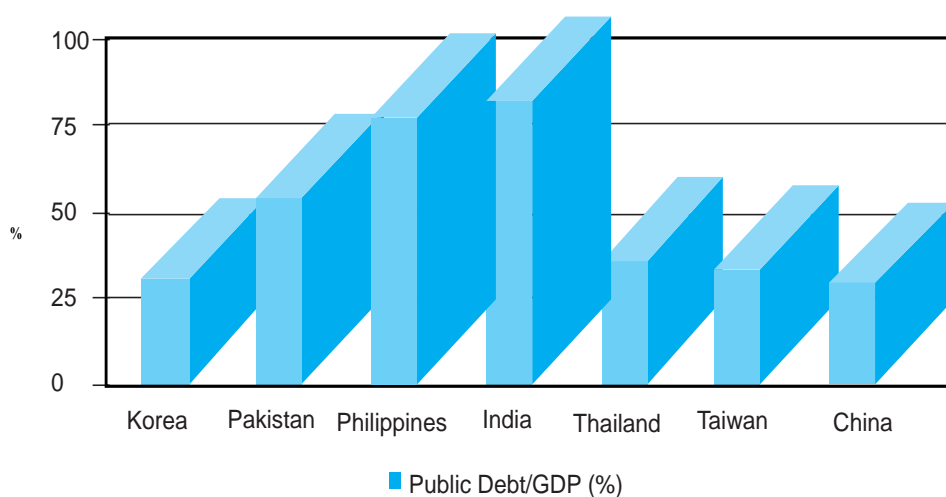
Total debt as percentage of GDP has been falling consistently since 2002. It fell from about 88% of GDP to 57.3% of GDP in 2006. Similarly, the external debt as percentage of GDP decreased from 46.5% in 2002 to 27.7% in 2006. The fall has come on the back of sharply rising Nominal GDP (CAGR of 15.7% during last four years).

Figure 04: Pakistan's Public Debt as percentage of GDP

Source: IMF & SBP

Such a high burden of external debt causes strain on the government's forex reserves and it makes government to spend significant part of its revenue (about 17.5% in 2006) on servicing of debt. However, the figure has come down significantly, debt services as percentage of revenue has come down from about 60% in 2002 to 17.5% in 2006. This leaves more for other necessary expenses such as salary and wages of employee, expenditure on healthcare and education. As a result better part of government's expenditure is available for capital expenditure that is necessary for sustainable development of Pakistan. In 2006 more than 20% of government expenditure was allocated to capital expenditure.

Figure 05: Public Debt as percentage of GDP (Year 2005)



Source: Financial Engineering News

Pakistan's public debt as percentage of GDP is comparable range to the public debt of the other countries at around 55%. While country such as India (82%), Philippines (77%) has higher debt. Japan has about 170% of its GDP as the public debt.

External Trade

Pakistan trade deficit is rising consistently Y-o-Y basis. It has risen from US\$294mn in FY02 to US\$8,464mn in FY06.

Pakistan is likely to see rise in trade deficit further in FY07. The figures for first seven month are US\$6,106mn. The reason for such rise is faster increase in imports as compared to that in exports. During FY02 to FY06 exports grew at CAGR of 16%, while import grew at CAGR of 27.6%. On Y-o-Y basis exports rose by 14.3%, while imports rose by 31.7% during FY06. The phenomenon is typical of rapidly growing economy where due to increased disposable income demand for external goods and services far outpace the exports.

Figure 06: Trade Balance



Source: IMF and SBP

Recent developments...

- The Agreement on South Asian Free Trade Area (SAFTA):** It was signed at Islamabad during the Twelfth SAARC Summit on Jan-04. The entry into force of the Agreement thus launches the South Asian Free Trade Area which would be completed by 1st January 2016. The first round of customs duty reduction took place, as agreed by the Member States, in July/August 2006.
- FTA with China:** According to Ministry of Commerce, the agreement was made on a free trade agreement between the two countries on 24th November, 2006. The Early Harvest Programme between the two countries which was put into operation on 1st January 2006, has been merged into this bilateral FTA. As the final outcome, Pakistan will get market access at zero duty on industrial alcohol, cotton fabrics, bed-linen and other home textiles, marble and other tiles, leather articles, sports goods, mangoes, citrus fruit and other fruits and vegetables; iron and steel products and engineering goods. China will also reduce its tariff by 50% on fish, dairy sectors; frozen orange juice; plastic products; rubber products; leather products; knitwear; woven garments etc.

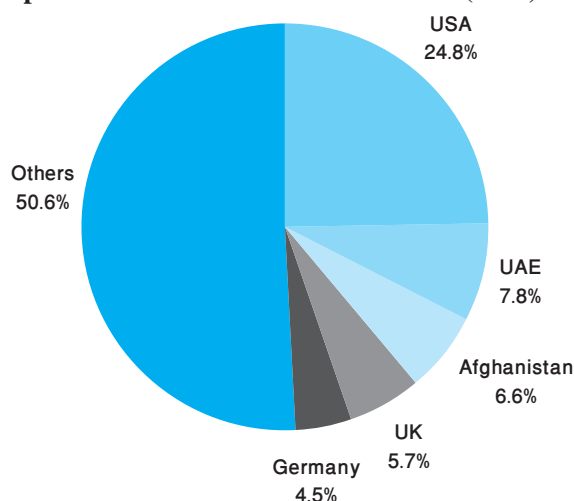
- **FTA with Sri Lanka:** Free Trade Agreement (FTA) between Pakistan and Sri Lanka is operational from Jun-05. According to Ministry of Commerce, the Free Trade Agreement, would enable Sri Lanka and Pakistan to have preferential market access to each others' exports by way of granting tariff concessions. Sri Lanka would be able to enjoy duty free market access on 206 products in the Pakistani market including tea, rubber and coconut. Pakistan, in return, would gain duty free access on 102 products in the Sri Lankan market. These products include oranges, basmati rice and engineering goods.

All these agreements are likely to enhance trade for Pakistan and would help to boost its economy.

Exports

Pakistan's major export partners are USA 24.8%, UAE 7.8%, Afghanistan 6.6%, UK 5.7%, Germany 4.5% (2005).

Figure 07: Export partners of Pakistan and their share (2005)



Source: CIA.GOV

Pakistan exports are concentrated to USA and dependent on its economy, which makes it vulnerable on the demand pattern from the country.

Exports - commodities: Top exports item are textiles (garments, bed linen, cotton cloth, yarn), rice, leather goods, sports goods, chemicals, manufactures, carpets and rugs.

Table 05: Export Items

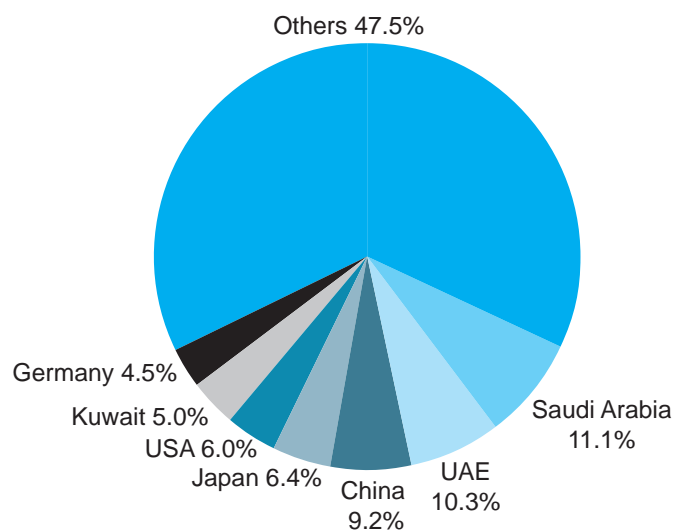
Figures in US\$ mn	Category	2005-06	2004-05	Y-o-Y Growth
A	Textile & Garments	10,087.5	8,926.0	13.0%
B	Other Core Products	3,922.5	3,188.4	23.0%
C	Developmental Categories	1,098.4	979.6	12.1%
D	All Others	1,444.6	1,388	4.0%
E	Total	16,553	14,482	14.3%

Source: Trade Development Authority of Pakistan

Imports

The top import partners of Pakistan are Saudi Arabia 11.1%, UAE 10.3%, China 9.2%, Japan 6.4%, US 6%, Kuwait 5%, Germany 4.5% as in year 2005.

Figure 08: Import partners of Pakistan and their share



Source: CIA.GOV

Pakistani imports are well diversified and not dependent on just one country, which should give it ability to absorb variations in supply from any particular country.

Imports – commodities: Top imports item are petroleum, petroleum products, machinery, plastics, transportation equipment, edible oils, paper and paperboard, iron and steel and tea.

Current Account

The FY06 witnessed significant dip in the current account balance, which registered a deficit of US\$5,015mn against deficit of US\$1,534mn in FY05. This dip came on the back of a 87.5% y-o-y increase in trade deficit (due to sharper increase in imports than that in exports) and 24.2% increase in debit for services in FY05. Current account deficit was kept in check by the net transfer, which grew by 21.8% on Y-o-Y basis.

The overall effect was- current account deficit increased from -1.4% of GDP in FY05 to -3.9% of GDP in FY06. The reason for increased imports has been increase in disposable income of Pakistani people leading to increased demand of goods, which we believe is a positive sign for the economy of Pakistan.

Table 06: Current Account Balance

<i>Figures in US\$ mn</i>					
Item	FY02	FY03	FY04	FY05	FY06
Goods: Exports f.o.b	9,140	10,974	12,459	14,482	16,553
Goods: Imports f.o.b	(9,434)	(11,333)	(13,738)	(18,996)	(25,017)
Trade Balance	(294)	(359)	(1,279)	(4,514)	(8,464)
Services: Credit	1,916	2,703	2,644	3,319	3,769
Services: Debit	(2,214)	(2,714)	(3,960)	(6,612)	(8,201)
Balance on Goods & Services	(592)	(370)	(2,595)	(7,807)	(12,896)
Income: Credit	111	170	187	437	784
Income: Debit	(2,430)	(2,381)	(2,394)	(2,823)	(3,451)
Of which :Interest Payments	(1,584)	(1,277)	(1,056)	(1,037)	(1,248)
Profit & Dividend	(851)	(990)	(1,228)	(520)	(521)
Balance on Goods & Services & Income	(2,911)	(2,581)	(4,802)	(10,193)	(15,563)
Current Transfers :Credit	5,789	6,714	6,713	8,768	10,655
Current Transfers :Debit	(45)	(72)	(100)	(109)	(107)
Current account balance	2,833	4,061	1,811	(1,534)	(5,015)
Current account balance as % of GDP	3.9%	4.9%	1.8%	-1.4%	-3.9%

Source: IMF & SBP

Situation is likely to continue on trade front with trade deficit for 1HFY07 has been US\$5,098mn (US\$4,023mn for the 1HFY06). On Y-o-Y basis imports are up by 14.2% and exports are up by 7.7% for the 1HFY07. The transfer would be in positive territory this year too, keeping deficit somewhat lower than it would have been otherwise.

Capital and Financial Account

The Capital and Financial account has been in surplus for last two years and it had seen big surge in FY06 to US\$6,096mn on the back of increased FDI and portfolio investment. Surplus in Capital and Financial account helped to keep overall balance on positive side in FY06.

Table07: Balance of Payment

<i>Figures in US\$ mn</i>	FY02	FY03	FY04	FY05	FY06
(1) Current account balance	2,833	4,061	1,811	(1,534)	(5,015)
(2) Capital Account	-	1,133	82	685	241
Capital Account: Credit	-	1,133	85	693	250
Capital Account: Debit	-	-	(3)	8	9
(3) Financial Account	(1,107)	(1,137)	(1,334)	446	5,855
Direct Investment Abroad	(2)	(27)	(45)	(66)	(71)
Dir. Invest. In Rep. Econ.	485	798	951	1,525	3,521
Portfolio Investment Net	(491)	(239)	314	620	986
Financial Derivatives Assets	-	-	-	-	-
Financial Derivatives Liabilities	-	-	-	-	-
Other Investment Assets	236	(216)	(669)	(1,352)	148
General Government	127	(18)	3	(2)	1
Banks	(53)	(25)	(220)	(986)	380
Other Sector	162	(173)	(452)	(364)	(233)
Other Investment Liab.	(1,335)	(1,453)	(1,885)	(281)	1,271
Monetary Authorities	(155)	(51)	2	(5)	-
General Government	(452)	(1,419)	(1,792)	574	794
Long-Term Disbursement	1,416	1,202	270	1,892	2,069
Long-Term Amortization	(1,513)	(2,421)	(2,419)	(1,434)	1,059
Banks	(90)	36	75	(55)	(2)
Other Sector	(638)	(19)	(170)	(795)	479
(4) Net Errors and Omissions	927	534	221	(7)	253
Overall Balance {(1)+(2)+(3)+(4)}	2,653	4,591	780	(410)	1,334

Source: IMF & SBP

The account is likely to show more surplus in FY07 on the back of increased FDI (up by more than 68% in first seven months of FY07 on Y-o-Y basis) and increased net portfolio investments on the back of rapidly growing economy of Pakistan.

Table 08: Percentage share of various countries in FDI inflow to Pakistan

Figures in %	FY03	FY04	FY05	FY06	FY07 (July to Jan.)
USA	26.5	25.1	21.4	14.7	24.5
UK	27.5	6.8	11.9	6.9	23.3
UAE	15.0	14.2	24.1	40.5	14.1
KSA	5.5	NA	NA	7.9	NA
Japan	1.8	1.6	3.0	NA	NA
Switzerland	NA	21.6	9.0	4.8	6.2
Norway	NA	15.4	NA	7.2	NA
Others	23.8	15.2	30.6	18.0	31.9
FDI (Total) US\$ mn	798.0	949.4	1,524.0	3,521.0	2,096.0
Y-o-Y increase in FDI	NA	19.0%	60.5%	131.0%	68.4%

Source: BOI Government of Pakistan (SBP)

Pakistan has been witnessing increasing FDI every year for last few years, USA, UK and UAE make a major percentage of investment in Pakistan (about 62% of total FDI). UAE has emerged as major investor with its investments making more than 40% of FDI to Pakistan in FY06. Besides this, Saudi Arabia (KSA) has been other important investor from the GCC countries. The liberalizing economy has attracted quite a few foreign acquisitions in Pakistani companies from foreign investors including that from GCC. For instance, Global Investment House (Global), a Kuwait based investment company acquired a 42.8% stake in the Karachi-based Jahangir Siddiqui Capital Markets Limited (JSCM) in CY2006.

Table 09: FDI Sector-wise

	Value in US\$ mn	Percentage Share
Communication	1,937.7	55.0
Financial Business	329.2	9.3
Power	320.6	9.1
Oil& Gas; Mining & Quarrying	312.7	8.9
Trade	118.0	3.4
Construction	89.5	2.5
Chemicals	62.9	1.8
Others	350.4	10.0
Total	3,521.0	100.0

Source: SBP

Communication led the tally with 55% of total FDI inflow in FY06. Financial Business, Power and Oil& Gas & Mining & Quarrying followed with 9.3%, 9.1% and 8.9% respectively.

Table 10: Worker Remittances (Cash)

<i>Figures in US\$ mn</i>			
Country	Jul-Mar (FY06)	Jul-Mar (FY07)	Y-o-Y growth (%)
USA	893.5	1,034.7	15.8
UK	305.4	319.3	4.6
KSA	515.6	733.5	42.3
UAE	491.3	596.0	21.3
Rest of GCC	429.3	538.3	25.4
EU Countries	87.6	110.4	26.0
Norway	11.7	14.4	23.1
Switzerland	14.8	13.0	-12.2
Australia	17.7	21.3	20.3
Canada	58.5	62.1	6.2
Japan	4.9	3.3	-32.7
Others	387.3	488.7	26.2
Total	3,217.6	3,935.0	22.3

Source: SBP

Worker remittances has increased during first eight months of FY07 (up by 22.3% on Y-o-Y basis). USA workers contributes the maximum over US\$1bn or 26.3% of total remittances, followed by Saudi Arabia (KSA) at US\$733.5mn or 18.6% of total remittances. Other major contributors are UAE and rest four of the GCC countries making US\$596mn and US\$583.3mn respectively.

Monetary Policy

The primary objectives of the central bank's monetary policy in Pakistan is to control the inflation rate, keep the excessive demand in check without hurting the growth momentum of the economy.

With this objective in mind, State Bank of Pakistan (SBP) not only focused on further monetary tightening but also allowed the export sector liberal access to concessional credit. SBP signaled a further tightening of monetary policy by first raising the cash reserve requirement for banks and then increasing its main policy rate - three day Repo rate by 50 bps to 9.5% with effect from 29 July 2006. In addition, to reinforce its tight monetary policy, SBP continued to focus on the short term interest rates by resorting to frequent open market operations to drain excess liquidity from the inter-bank market. The optimal soakage of liquidity from the market not only kept the overnight rates close to the discount rate, but the volatility in the short-term interest rates also decreased during 1HFY07.

SBP ensured availability of long-term financing for export related projects at lesser interest rate and decreased the interest cost of eligible items under the export refinance scheme in order to ensure availability of finance for industrial sector investment.

Incentives for industrial and export Sector ...

As SBP increased the key policy rate to further tighten the monetary policy in Jul-06, various relief measures were introduced to limit the cost of borrowing for the industrial sector as well as exporters. As per the information available with SBP, the major steps taken in this regard are as follows:

- In Jul-06, the maximum margin/spread for banks/DFIs on loans under Long Term financing for the Export-Oriented Projects was reduced from 3% p.a. to 2% p.a.. This 100 bps decline in spread was designed to reduce the cost of borrowing by the same percentage points.
- SBP also reduced the refinance rate under export finance scheme by 100 bps to 6.5 percent in July 2006 and capped the maximum margin/spread of banks at 1 percentage point from 1.5 percentage points earlier.
- Besides this reduction in cost, the credit limits for participating financial institutions were also increased to match the growing financing requirements under this scheme.

Increasing money supply...

Money supply for Pakistan has been increasing consistently; this coupled with consistently high money velocity (more than 2.2 for last three years) has been the precursor of high inflation.

Table 11: Money Supply

Figures in US\$ mn	FY04	FY05	FY06	FY07 (until 14 Apr-07)	FY06 (until 15 Apr-06)	Y-o-Y Change till Apr-07 in %
1. Currency in Circulation	9,942.7	11,153.8	12,305.4	1,956.9	1,661.3	17.8
2. Other Deposits with SBP	NA	56.2	82.0	16.4	5.6	192.9
3. Demand Deposits	NA	15,996.2	18,203.2	21,651.7	652.7	3,217.3
4. Time Deposits	NA	19,460.5	22,942.5	(17,104.3)	2,328.9	NM
5. Resident Foreign Currency Deposits (RFCDs)	NA	3,019.9	3,249.2	28,738.6	135,574.5	-78.8
M1 (1+2+3)	NA	27,205.4	30,590.8	23,625.0	2,319.6	918.8
M2 (1+2+3+4+5)	42,765.3	49,687.2	56,782.2	6,549.7	4,784.1	36.9

Source: SBP

NM: Not Meaningful

From the figures, we have made notable observations for the period of 1 Jul-06 to Apr-07:

- Currency in circulation is up by 17.8%
- M1 is up by 919%; the reason being that demand deposits (one of the components of M1) went up by 3,217%
- M2 has gone up by 36.9%
- During FY-07, M2 is less than M1; reason for this being negative figures recorded by time deposits (-US\$17.1bn)

Both domestic assets and net foreign assets improved marginally in 2006 on Y-o-Y basis. Domestic assets were up by 20% to reach US\$50.2bn in 2006, while net foreign assets notched up by 11.2% to reach US\$12.7bn. Net foreign assets climbed further by 2% to reach US\$13bn in Jan-07. Broad money liabilities increased by 15.2% on Y-o-Y basis in year 2006.

Claims on both private and public sectors have been increasing, however, claims on public sector (Central government 14.9%, General government 13.8% Y-o-Y basis for the year 2006) have risen much slower as compared to claims on private sector (22.3% Y-o-Y basis for the year 2006)

Following are the main figures from the monetary surveys:

Table 12: Monetary Survey

Figures in US\$ mn	2005		2006		2007
	June	December	June	December P	January P
Description					
Net Foreign Assets	11,513.3	10,416.4	12,706.7	12,520.7	12,867.7
Claims on nonresidents	15,870.4	14,710.2	16,904.2	16,704.4	17,059.6
Less: Liabilities to nonresidents	4,357.0	4,293.8	4,197.5	4,183.7	4,191.9
Domestic Credit	42,166.2	48,406.4	50,201.0	54,410.0	53,912.9
Net Claims on General Government	11,955.4	13,095.7	13,504.5	13,689.1	13,461.0
Net Claims on Central Government	13,534.9	14,793.0	15,426.1	15,907.6	16,138.3
Claims on central government	16,728.4	18,940.5	19,560.0	19,797.4	19,959.1
Less: Liabilities to central government	3,193.5	4,147.5	4,133.9	3,889.8	3,820.8
Net Claims on Provincial Government	-1,579.5	-1,697.3	-1,921.7	-2,218.4	-2,677.3
Claims on provincial governments	746.3	829.6	1,159.9	689.4	563.2
Less: Liabilities to provincial governments	2,325.8	2,526.9	3,081.6	2,907.8	3,240.5
Claims on Private Sectors	26,815.6	31,212.9	32,532.3	36,192.0	36,158.9
Claims on NFPSEs	1,782.7	2,093.7	2,263.8	2,240.8	2,130.9
Claims on NBFIs Depository & Non Depository	1,612.5	2,004.1	1,900.5	2,288.1	2,162.2
Broad Money Liabilities	49,666.7	53,672.9	56,797.0	60,424.5	59,756.0
Currency outside depository corporation (Banks)	11,162.4	12,271.4	12,321.2	14,396.7	13,693.6
Transferable deposits (demand deposits)	30,917.2	29,212.3	33,056.0	32,682.0	33,175.7
Other deposits (Quasi-Money)	7,587.1	12,189.1	11,419.8	13,345.8	12,886.7
Public Sector Funds/Deposits (SBP)	397.2	386.0	386.0	385.5	386.5
Counterpart Funds	9.0	8.8	9.1	8.4	8.4
Other Items (Net)	3,604.7	4,753.4	5,714.4	6,111.3	6,627.7
Other liabilities	11,464.6	13,055.3	14,382.3	16,560.8	17,219.4
Less: Other assets	7,859.9	8,301.9	8,667.9	10,449.6	10,591.7
Memorandum Items:	-	-	-	-	-
Bank clearings	23,728.3	27,775.7	30,824.9	31,088.4	25,723.5
Post office savings	801.2	658.1	1,020.8	872.1	874.2

Source: SBP

P: Projected Figures

In the coming years we expect share of private sector's claims to grow further as compared to that of government sector's. This should lead to stronger market discipline, and, in the process, the ability of emerging market borrowers to protect themselves against volatility and herd behavior of fleeing by the debtor in times of crisis.

Foreign Exchange Reserves

Pakistan's foreign exchange reserves have been on rise on average for last five years and stood at fair level of US\$13,136.9mn at Jun-06, which means Y-o-Y increase of 4.1%.

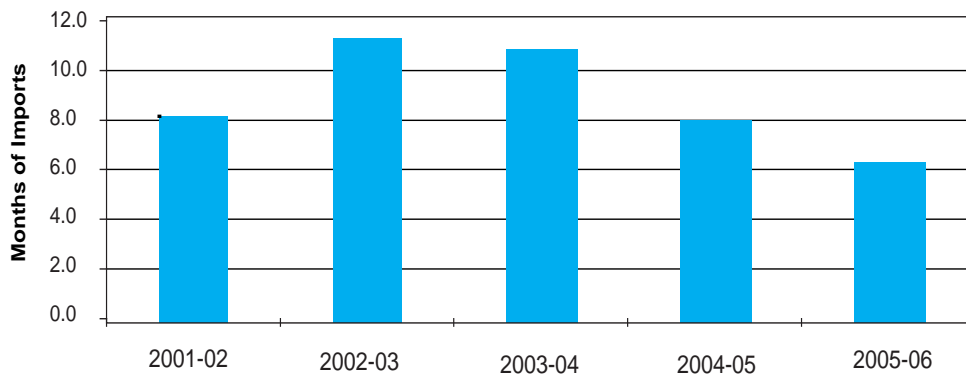
Table 13: Forex Reserves

Figures in US\$ mn	FY02	FY03	FY04	FY05	FY06	CAGR
Net Reserves with SBP	4,333.4	9,525.1	10,553.9	9,790.7	10,760.2	25.5%
Net Reserves with Banks	2,098.2	1,193.9	1,785.3	2,832.7	2,376.7	3.2%
Total Liquid Reserves	6,431.6	10,719.0	12,339.2	12,623.4	13,136.9	19.5%

Source: SBP

Pakistan total forex reserves has grown at healthy pace of 19.5% in last four years as a result of growing economy and increasing FDI and portfolio investments. Net Reserves with SBP has grown at much better rate of 25.5% as compared to net reserves with commercial banks, which grew at 3.2%.

Figure 09: Pakistan’s Forex Reserves



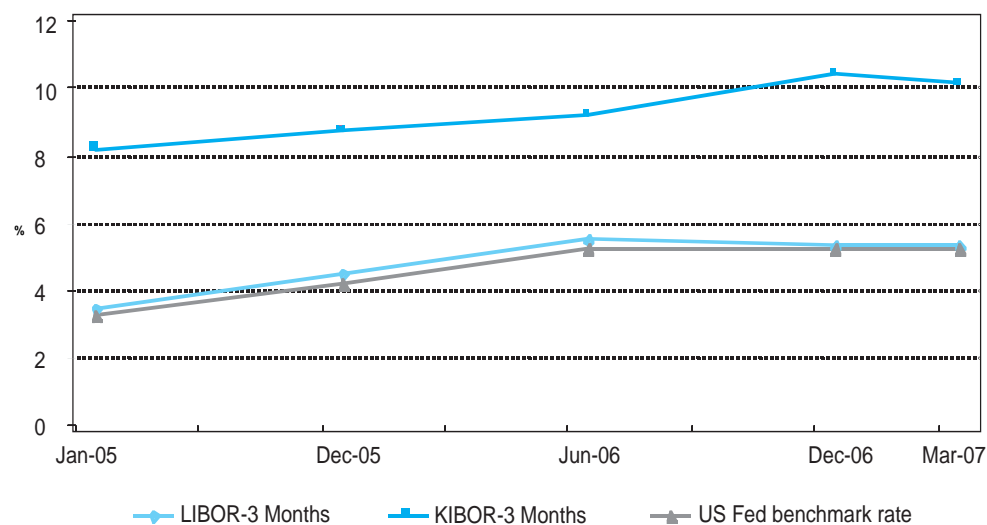
Source: SBP

Despite a healthy increase in forex reserves, reserves in terms of months of imports fell from a high of 11.3 months of imports in FY03 to 6.4 months of imports in FY06. The reason for this fall is high growth in imports which grew by 117% in last three years (CAGR of 29.5%).

Interest Rates

Interest rates in Pakistan closely follow that in developed markets such as USA and UK.

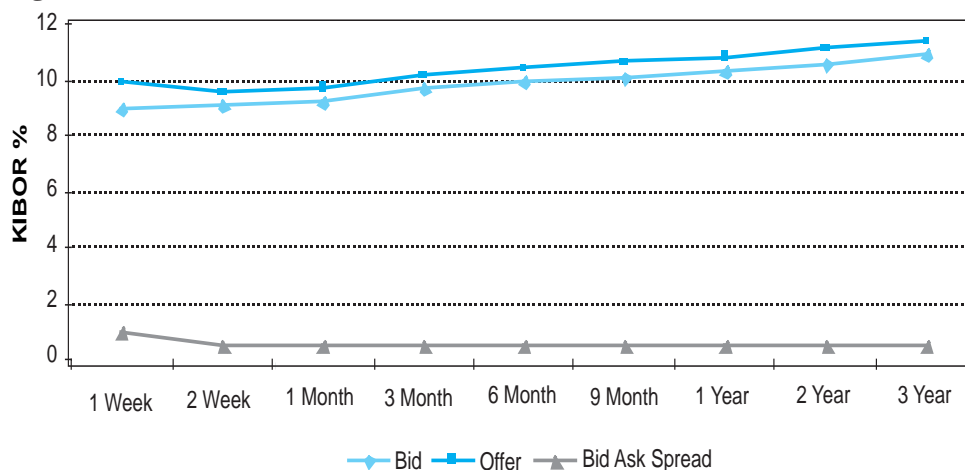
Figure 10: US Fed Rate, LIBOR- 3 Months & KIBOR -3 Months



Source: SBP & Economagic.com

Since Jul-03 LIBOR have been on constant rise (LIBOR- 3 months increased from 1.103% in Jul-03 to 5.52% till Jul-06, an increase of 4.417%), while Karachi Interbank Offered Rate (KIBOR)- 3 months peaked around Dec-06 to 10.42% and it eased to 10.17% by Mar-07. The increase in the interest rate has been the part of the effort by central bank to curb the inflation.

Figure 11: Interest Rates in Pakistan



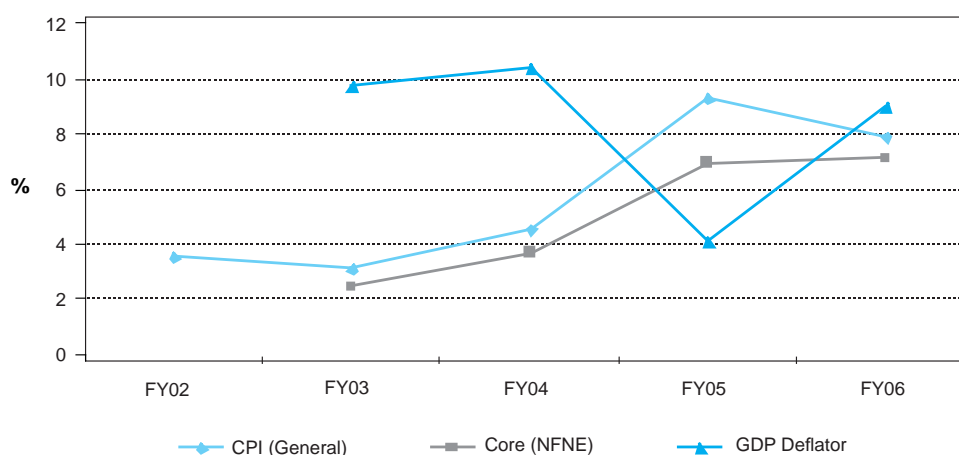
Source: SBP

The bid ask spread for the interest rates is constant at 0.5% or 50 bps for all durations except one week lending.

Inflation

Pakistan economy has experienced low inflation 2000 onward. CPI has always been below 8% since FY2000 (except FY05), according to SBP. The inflation rate in FY2006 as measured by the percentage change in the Consumer Price Index dipped to 7.9% from 9.3% in FY2005.

Figure 12: Inflation



Source: SBP

The reason for fall in CPI was tight monetary policy adopted by SBP such as raising the cash reserve requirement for banks and then increasing its main policy rate, the SBP three day Repo rate by 50 bps to 9.5% in Jul-06.

Table 14: Inflation in Pakistan Economy

	CPI			Core Inflation		GDP Deflator
	General	Food	Non-food	NFNE	Trimmed	
FY02	3.54	2.5	4.24	NA	NA	NA
FY03	3.1	2.84	3.28	2.46	3.61	9.7
FY04	4.57	6.01	3.62	3.71	4.1	10.4
FY05	9.28	12.49	7.1	6.96	8.77	4.1
FY06	7.92	6.92	8.63	7.11	6.72	9.0
Feb-07	7.69	8.75	6.94	6.0	6.55	NA

Source: SBP

* NFNE – Non Food Non Energy

While CPI dropped in FY06, Core inflation rose slightly from 6.96% in FY05 to 7.11% in FY06. GDP deflator also rose by 4.9% to reach 9.0% in FY06.

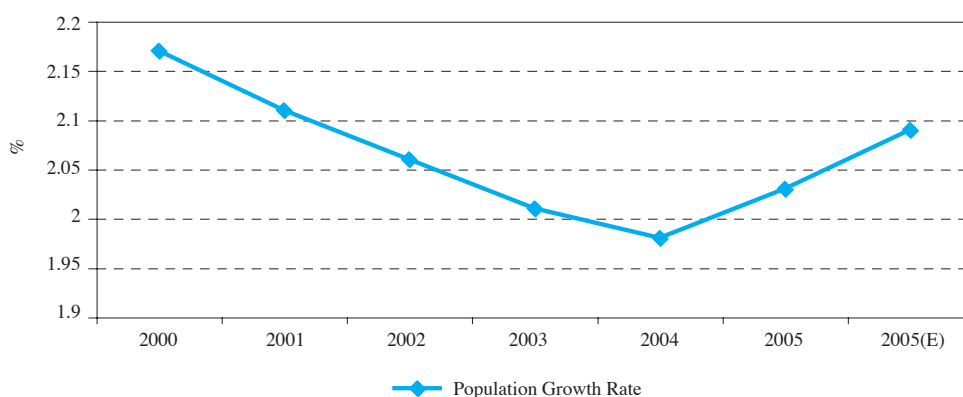
On Y-o-Y basis inflation was lower in Feb-07 except for CPI on food items, which increased by 1.83% to reach 8.75%.

Looking forward we expect inflation to remain in check as indicated by commitment of SBP to keep the inflation in check and the success of tight monetary policy applied by SBP in doing so.

Population and Demographics

The population of Pakistan is 165.8mn as per the latest estimates (Jul-06) by CIA. The population growth rate decreased from 2001-2004. The population growth rate for Pakistan is higher as compared to that in other Asian countries such as India and China.

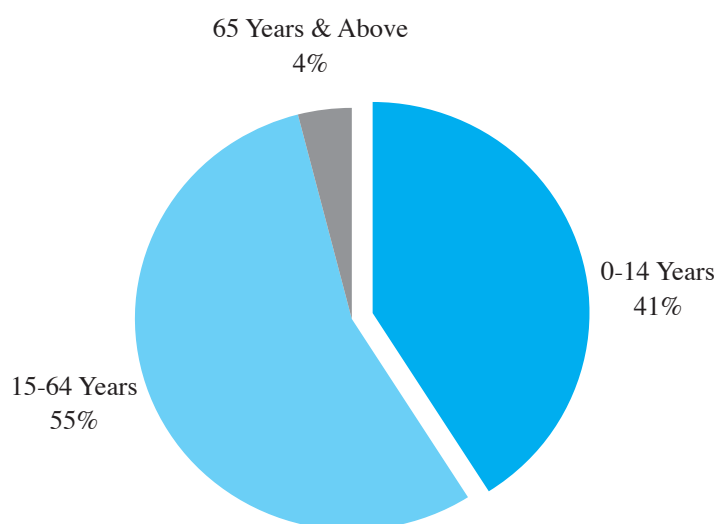
Figure 13: Population Growth Rate



Source: Index Mundi

Pakistan's population consists of mainly young people as 41% of people are less than 15 years and 34% of the people are 10 years to 24 years of age. Pakistani people have low literacy rate of about 54% (as per 2006 estimates by Population Reference Bureau). This means Pakistan needs to pay attention to this part of its development in order to have skilled labor force and more economically productive people.

Figure 14: Population Structure (2006)



Source: Population Reference Bureau

As Pakistan has significant number of people in young age group, we expect demand for housing to go up in the next ten years. In addition to it, we can expect increased participation by the Pakistani people in labor market, which is a good sign for housing and financial services companies.

Economic Activity Rate & Unemployment

The economic activity rate measures the percentage of the population who are in employment or unemployed, and is therefore a useful general measure of the labor market opportunities available to people.

As per the latest estimates available (2005) with Population Reference Bureau, economic activity rate for male is 83% and for female is 16%. The low level of economic activity for female is partly explained by low level of literacy among them 42% as compared to 66% for males.

Unemployment rate is higher in Pakistan as compared to that in developed countries, however, it is lower than that in India or other developing countries.

Table 15: Unemployment rate

Year	Unemployment Rate (%)
2002	7.8%
2003	7.7%
2004	8.3%
2005	6.6%
2006	6.5%

Source: CIA World Fact book

As a result of growing economy unemployment rate in Pakistan is dropping every year (except in 2004). It has dropped from 7.8% in 2002 to 6.5% in 2006.

Structural Reforms

In last few years Pakistan has taken several measures pertaining to structural reforms, which have helped it boost its economy, increase its forex reserves and curtail the public sector enterprises (PSE) losses. As per the information available with IMF, we have given description of main one out of them:

Deepening domestic financial markets: Efficiency of financial intermediaries would be a key element for Pakistan to maintain its high growth. The Pakistan undertook modernisation of the National Savings Schemes (NSS), and the phased reform of the system of broker-financing of stock trading (“Badla”) which is evidence of its continued efforts to develop domestic financial markets. Soundness indicators for banking system have continued to improve, and stress tests done recently by the SBP do not reveal weak points in the banking system.

As world economies become more and more interdependent in the wake of globalization and the banking system grows in its complexities, role and responsibilities of the central banks have increased a great deal. In recognition of this trend, government of Pakistan is envisaging the next stage of financial sector reforms. This would involve focus mainly on:

- Further consolidation & restructuring of the banking sector;
- Developing capacities to cater to unmet requirements of special segments of the economy and catering to diverse needs;
- Strengthening of risk management systems;
- Diversification of the financial sector by further development of the equity and debt markets which, while fairly vibrant, need to play a more significant role in meeting the economy’s financing requirements;
- Promoting financial product innovations;
- Implementation of good corporate governance practices among banks and central bank along with effective enforcement of regulations.

Increasing government revenues: On tax administration, there has been recent progress on rolling out large- and medium-taxpayer offices, and reform priorities going forward—include improvement of audit strategies, and advancing the functional integration of income and sales tax administration. This has led to increased tax collection by the government resulting in increased government revenue.

Improving public service delivery. Steps are being taken to improve the efficiency and composition of government spending and strengthen public financial management, including through technical assistance from Federal Archaeology Department (FAD). Work conducive to the doubling of spending on education and health as a share of GDP

within 10 years (as mandated by the 2005 Fiscal Responsibility Law) is underway, including through the rolling out of medium-term budget frameworks in several key ministries and the preparation of a new Poverty Reduction Strategy Paper.

Trade liberalization. Pakistan remains committed to a liberal trade regime, but the progress in trade liberalization has been affected by the inconclusive Doha round. Pakistan's textile exports performed reasonably well following the January 2005 expiration of the Multi-Fiber Agreement. Pakistan's increased efforts to sign preferential trade agreements with several countries has been part of a global trend. It has signed trade agreement with Sri Lanka and China in 2005 and 2006 respectively.

Taxes

Fiscal year extends from 1 July to 30 June of a year. Federal taxes in Pakistan are classified into two broad categories, viz., direct and indirect taxes. As per the information available with AsiaTradeHub the administration of these taxes is explained below:

Direct Taxes:

Direct taxes primarily comprise income tax, along with supplementary role of wealth tax. For the purpose of the charge of tax and the computation of total income, all income is classified under the following heads:

1. Salaries
2. Interest on securities;
3. Income from property;
4. Income from business or professions
5. Capital gains; and
6. Income from other sources.

Personal Tax: All individuals, unregistered firms, associations of persons, etc., are liable to tax, at the rates ranging from 10% to 35%.

Tax on Companies: All public companies (other than banking companies) incorporated in Pakistan are assessed for tax at corporate rate of 39%. However, the effective rate is likely to differ on account of allowances and exemptions related to industry, location, exports, etc.

Dividend Tax: Tax on the dividends received by a public company from a Pakistan company is payable at the rate of 5% and at the rate of 15% in case dividends are received by a foreign company. Inter-corporate dividends declared or distributed by power generation companies is subject to reduced rate of tax i.e., 7.5%. Other companies are taxed at the rate of 20%. Dividends paid to all non-company shareholders by the companies are subject to withholding tax of 10% which is treated as a full and final discharge of tax liability in respect of this source of income.

Treatment of dividend income: Dividend income received as below enjoys tax exemption, provided it does not exceed PKR10,000.

1. Dividend received by non-resident from the state enterprises Mutual Fund set by the Investment corporations of Pakistan.
2. Dividends received from a domestic company out of income earned abroad provided it is engaged abroad exclusively in rendering technical services in accordance with an agreement approved by the Central Board of Revenue.

Unilateral Relief: A person resident in Pakistan is entitled to a relief in tax on any income earned abroad, if such income has already been subjected to tax outside Pakistan. Proportionate relief is allowed on such income at an average rate of tax in Pakistan or abroad, whichever is lower.

Customs: Goods imported and exported from Pakistan are liable to rates of Customs duties as prescribed in Pakistan Customs Tariff. Customs duties in the form of import duties and export duties constitute about 37% of the total tax receipts. The rate structure of customs duty is determined by a large number of socio-economic factors.

Central Excise: Central Excise duties are leviable on a limited number of goods produced or manufactured, and services provided or rendered in Pakistan. On most of the items Central Excise duty is charged on the basis of value or retail price. Some items are, however, chargeable to duty on the basis of weight or quantity. Classification of goods is done in accordance with the Harmonized Commodity Description and Coding system which is being used all over the world. All exports are exempted from Central Excise Duty.

Sales Tax: Sales Tax is levied at various stages of economic activity at the rate of 15% on all goods imported into Pakistan, payable by the importers all supplies made in Pakistan by a registered person in the course of furtherance of any business carried on by him. There is an in-built system of input tax adjustment and a registered person can make adjustment of tax paid at earlier stages against the tax payable by him on his supplies. Thus the tax paid at any stage does not exceed 15% of the total sales price of the supplies.

Table 16: Tax Collection

<i>Figures in US\$ mn</i>	Direct Taxes	Indirect Taxes			Total	Total Taxes
		Sales	Excise	Customs		
FY02	2,373.8	2,774.6	786.0	796.6	4,357.1	6,731.0
FY03	2,626.6	3,374.3	773.9	1,190.3	5,338.5	7,965.2
FY04	2,839.2	3,769.5	783.4	1,565.9	6,118.8	8,958.0
FY05	3,071.5	3,995.5	889.5	1,932.5	6,817.5	9,889.0
FY06	3,739.3	4,899.5	918.6	2,299.9	8,118.1	11,857.4
FY07 (until Dec-06)	2,842.8	2,407.2	507.5	999.9	3,914.6	6,757.4

Source: SBP

Tax collection (direct and indirect) has consistently increased every year from FY02 to FY06. On Y-o-Y basis it grew by 20.8% in FY06 to reach US\$11,857.4mn. In 1HFY07 it increased by 26.7% to reach US\$6,757.4mn.

Privatization

Privatisation Commission (PC)

On September 28, 2000, the Government promulgated the PC Ordinance 2000, which strengthened the PC's legal authority as a corporate body for implementing the government's privatisation policy. The measure increased PC's accountability and independence and is expected to provide conducive environment to the investors. It also specified that 90% of net privatisation proceeds would be allocated to debt retirement and 10% to poverty alleviation programs.

Achievements

Privatisation efforts began with urgency after the creation of Privatisation Commission on January 22, 1991. Although the PC mandate initially focused on industrial transactions, by 1993 it also encompassed Power, Oil & Gas, Transport (aviation, railways, ports and shipping), Telecommunications and Banking and Insurance. According to PC, during January 1991 to June 2006 the Commission completed 158 transactions for PKR353.6bn (about US\$5.9bn).

As per the information available with PC, during the financial year 2005-2006, the Commission successfully completed seven transactions, which includes privatisation of 26% B class shares of Pakistan Telecommunication Company Limited (PTCL), 73% shares of KESC, 85.29% shares of Mustehkam Cement, PTCL shares in Carrier Telephone Industries, Bolan Textile Mills and Capital Market transaction of United Bank Limited (UBL) IPO. The total sale price amounts to US\$2.9bn compared to US\$0.7bn of the year 2004-2005. Against the sale price of PTCL shares amounting to US\$2,5989mn, the initial payment of US\$1,400mn has been received up to 30 June 2006 and the balance sale price is recoverable in nine semi-annual installments up to September 2010. The first installment of US\$133.2mn due in September 2006 has been received. The Commission has remitted an amount of US\$1.6bn to the government for debt retirement and poverty alleviation and paid an amount of US\$0.4bn to direct foreign investment (DFI)/owners for their shares sold in 2005-2006.

The Commission during period from July 2006 to December, 2006, has successfully completed privatisation of five transactions amounting to US\$1.1bn. This includes Oil and Gas Development Limited (OGDCL) GDR to the foreign institutions, OGDCL shares to domestic institutions, sale of Javedan Cement Limited, Lyallpur Chemical & Fertilizers and Lasbella Textile Mills. To date, government of Pakistan had completed or approved 163 transactions at gross sale price of US\$7.1bn (PKR421.2bn).

Table 17: Number of Privatized Transactions

<i>Figures in PKR mn</i>	From 1991 to		From Jul 05		From Jul 06		Total	
	Jun 05		to Jun 06		to Dec 06			
Sector	No.	Amount	No.	Amount	No.	Amount	No.	
Banking	7	41,023	-	-	-	-	7	41,023
Capital Market Transaction	17	31,103	1	1,087	1	46,963	19	79,153
Energy	13	37,319	1	15,860	-	-	14	53,179
Telecom	2	30,558	2	155,500	-	-	4	186,058
Automobile	7	1,102	-	-	-	-	7	1,102
Cement	15	8,655	1	3,205	1	4,316	17	16,176
Chemical / Fertilizer	21	24,355	-	-	2	16,229	23	40,584
Engineering	7	183	-	-	-	-	7	183
Ghee Mills	22	838	1	8	-	-	23	846
Rice / Roti Plants	23	328	-	-	-	-	23	328
Textile	2	87	1	128	1	156	4	371
Newspapers	5	270	-	-	-	-	5	270
Tourism	4	1,805	-	-	-	-	4	1,805
Others	6	160	-	-	-	-	6	160
Total	151	177,786	7	175,788	5	67,664	163	421,238

Source: Privatization Commission

Though almost all the transactions were settled in local currency, about 68.9% of the proceeds have been received in foreign exchange from transactions pertaining to 2nd tranche of PTCL vouchers, Kot Addu Power Plant (KAPCO), Six Oil & Gas Concessions, Habib Credit & Exchange Bank, United Bank Limited, Habib Bank Limited, KESC, 26% shares of PTCL and OGDCL GDR.

Out of these transactions, about 78% of the proceeds received were transferred to the Federal Government, 17% was returned to legal entities whose shares were sold, 2.0% was used for restructuring expenses associated largely with golden handshakes and rehabilitation, and 2.5% was used for PC's privatisation-related expenditures.

Sectors Performance

Agriculture Sector

According to Pakissan, the total geographical area of Pakistan is 0.8mn square km. About 25% of this surface is arable land. Of the area under cultivation, about 80% is irrigated, which makes Pakistan having one of the highest proportions of irrigated cropped area in the world, while crop production in the remaining 20% depends mainly upon rainfall. The cultivable waste lands offering good possibilities of crop production amount to about 9mn hectares.

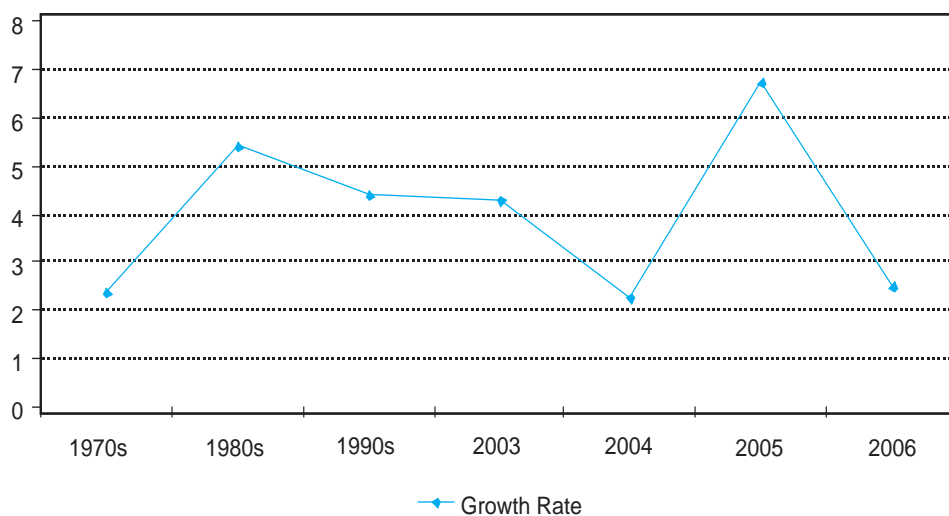
Most of Pakistan is arid to semi-arid for the agriculture point of view because rainfall is not sufficient to grow crops. About 30% area has annual rainfall of 500 mm or more. Thus additional water is required for profitable agricultural production, which is availed through irrigation or through water harvesting.

The country has great potential for producing all types of food commodities. Main products are: Cotton, wheat, rice, sugarcane, fruits, vegetables; milk, beef, mutton, eggs.

Wheat is a staple food crop of Pakistan, dominating all crops in acreage and production. Mainly grown under irrigated conditions, wheat water requirements range from 20-21 in/acre. The government has set a target of 22.5mn tons of wheat during current season. Agriculture has an important role in the economic growth of the country. The importance of agriculture to the economy is three-fold: first, it provides food to consumers and fibres for domestic industry; second, it is a source of foreign exchange earnings; and third, it makes a market for industrial goods.

Agriculture contributes about 22% of the gross domestic product (GDP) and employs 43.4% of the national employed labor force. The contribution of the agricultural sector to the GDP has declined gradually since Pakistan came into existence, from over 50% in 1949-50 to about 21.6% in 2005-06. Agriculture still remains the major sector of the GDP composition. A major part of the economy depends on farming through production, processing and distribution of major agricultural commodities.

In foreign trade agriculture again contributes significantly, through exports of raw products such as rice and cotton and semi-processed and processed products such as cotton yarn, cloth, carpets and leather production.

Figure 15: Growth rate in Agriculture Sector in Pakistan

Source: SBP

The average annual growth rates in the agricultural sector during the 1970s, 1980s and 1990s were 2.4%, 5.4% and 4.4% respectively. The growth rate during FY2005 was high at 6.7% in FY2006 it dropped to 2.5%.

The agricultural sector plays an important role in Pakistan's economy by:

- contributing 21.6% towards GDP;
- providing food to about 166mn people;
- providing employment to 43.4% of the total work force;
- providing the main source of livelihood for the rural population of Pakistan;
- providing raw materials for many industries and a market for many locally produced industrial products.

Agricultural sector development

At the time of independence in 1947, the agriculture was in primitive form. The Indus Basin was irrigated with an extensive system of canal irrigation, sown with low-yielding seed varieties, fertilized mainly with manure derived from animal excreta and cultivated by means of animal tillage and by hand.

As per the information available with Pakistanweb.com, in the early 1960s, the Indus Water Agreement was signed; the Indus Basin Development Fund established with multi-donor support; government improving the terms of agricultural trade and tubes were installed. That decade witnessed a green revolution in Pakistan, and production accelerated during the first part of the decade, primarily because of the increased use of inputs. Pakistan's agriculture's performance is marked by a mixed trend. There have

been some years of poor growth and some years of good growth. Agricultural GDP at constant factor cost has increased significantly from more than US\$2.4bn (PKR141bn) in 1996-97 to US\$17.5bn (PKR1,054bn) in FY06, with a CAGR of 25%. Agriculture's share of total GDP however, declined from about 31% to just 21.6% over the same period.

During the past 60 years a significant increase in production of the major crops has been achieved. Wheat production is expected to rise from 3.3mn tons in 1950/51 to 22.5mn tons in 2007. Similarly during this period rice production rose from 0.86mn tons to 5.4mn tons.

Policy measures in the last few years, were enhancing for the agricultural sector. Export taxes on agricultural commodities were reduced or eliminated, which benefited the agricultural sector. The other measures taken in the policy reforms package, are better support prices, better tillage and soil preparation practices and adequate and timely availability of fertilizer and certified seed. All this is likely to improve agricultural production in coming years.

In order to address the issues of prompt actions for export of agricultural commodities and to keep vigilance around the globe for potential export of Pakistani agricultural commodities, the government plans to set up an "Agricultural Export Promotion Cell". Over the past 20 years some important structural changes have taken place in the sector. According to the information available with Pakistanweb.com, livestock contributes more than one-third of agricultural GDP, compared with about 28% twenty years ago. Similarly, fisheries and forestry, while still minor contributors to agricultural GDP, have grown rapidly. Structural changes have also taken place within the crop sector. Cotton is now as important as wheat in terms of value added with a one-fifth share of total earnings. Rice and sugar have, however, fallen from a 20% share in the early 1970s to less than 15% currently. Finance to agriculture sector has gone up by 23% to US\$2.6bn in 2007 (US\$2.2bn).

The outlook for agriculture sector remains positive. However, the growth for the sector will be lower as compared to overall economy, which is a normal phenomenon for any developing economy that with growth share of the agriculture sector in overall economy come down.

Manufacturing Sector

The industrial sector makes about 18.2% of GDP (as per 2006 figures). The sector employs 13.8% of the people employed in Pakistan. Reflecting the impact of structural reforms that Pakistan has made and overall growth in economy in last few years, the sector has grown at about CAGR of 10.5% during the period of 2003-06. This is much higher as compared to overall growth in economy, which grew at 6.8% during the period.

Table 18: Growth Performance of Manufacturing Sector (% growth at constant costs)

<i>Figures in %</i>	2003	2004	2005	2006	CAGR 2003-06
Manufacturing Sector	6.9	14.0	12.6	8.6	10.5
GDP Growth	4.7	7.5	8.6	6.6	6.8

Source: SBP & IMF

The pace of industrialization since independence has been rapid, for Pakistan, albeit the rate of growth has fluctuated in tandem with that of world's. As per information available with US Library of Congress, during the 1950s, manufacturing sector expanded at about 16% annually; during the first half of the 1960s, it expanded at around 11% a year. The pace slowed to under 7% a year in the second half of the 1960s. Between 1970 and 1977, the index of manufacturing output increased an average of only 2.3% a year. Between 1977 and 1982, the index rose at an average rate of 9.9% a year. Growth averaged 7.7% during the Sixth Five-Year Plan (1983-88) and 5.4% from 1989 through 1992. In 1993, manufacturing accounted for 17.3% of GDP at current factor cost, of which large-scale manufacturing accounted for 61% and small-scale manufacturing for 39%.

During 2006, large-scale manufacturing accounted for about 80% and small-scale manufacturing for 20%. In the early 1990s, the manufacturing sector was dominated by food processing and textiles. Provisional figures for 1992 indicated that sugar production was 2.1 million tons, vegetable ghee 819,000 tons, cotton yarn 862,000 tons, and cotton cloth 234 million square meters. Other industrial products included motor tyres (647,000 units), cycle tyres (2.2 million units), cement (6.1 million tons), urea (1.4 million tons), soda ash (147,000 tons), bicycles (364,000 units), and paperboard (13,000 tons).

In 2006, textile made 24.5%, of total industrial production food 14.4%, petroleum 5.2%, pharmaceutical 5.0% and chemical made 4.8% of the total manufacturing production.

Large Scale Manufacturing has grown even faster in recent years, touching 15.2% in FY05 and 10.7% in FY06. This was facilitated by several factors, chief among them has been macroeconomic stability, rationalisation of tariffs, increased investments, and improved utilisation of productive capacity.

Table 19: Selected large scale manufacturing items

Item	Weight	Percent change in 2006
Textile	24.5	4.3
Food items	14.4	5.3
Petroleum	5.2	2.2
Pharmaceuticals	5.03	12.9
Chemicals	4.8	11.2
Non-metallic minerals	4.2	12.7
Automobile	4	25.8
Metal Industries	3.5	-13.5
Fertilizers	3.4	5.1
Electronics	2.5	36.5
Leather products	2.3	5.8
Paper & board	0.6	13.2
Engineering items	0.4	31.2
Tyres & tubes	0.3	12.3
Wood products	0.03	40.6
Overall growth		10.7

Source: SBP

The growth in demand for manufactured products was further fuelled by higher exports and consumer financing in the country. Manufacturing contributes more than 18% to GDP, and employs about 14% of employed labor force; its contribution to export earnings is about 80%.

Table 20: Capacity Utilization in Selected Industries

<i>Figures in %</i>				
Industry	FY03	FY04	FY05	FY06
Textile	56.3	55.9	58.2	59
Automobiles	59.6	75.7	82.7	97.8
Cement	69.9	79.1	91.3	87.9
Industrial Chemicals	107.0	88.8	85.2	85.6
Overall Capacity Utilization	63.0	65.9	66.2	66.3

Source: SBP

Capacity utilization has improved in most of the industries over the years . Capacity utilization in Automobile has improved significantly over last three years from 59.6% in FY03 to 97.8% in FY06. Such a significant improvement in capacity utilization in Automobile sector is hallmark of improving health of economy of Pakistan. Cement industry has followed similar trends improving capacity utilization from 69.9% in FY03 to 87.9% in FY06. Overall capacity utilization improved from 63.0% in FY03 to 66.3% in FY06.

Table 21: Manufacturing Value Added in Exports

Country	Manufacturing Value (MVA) /Capita in Exports (US\$)	Share of Medium & High Tech Goods in Manufacturing (%)	Trade to GDP Ratio (%)
1 Pakistan	58	10.1	37.3
2 India	38	19.7	28.7
3 China	234	46.6	56.9
4 Brazil	222	51.5	29.8
5 Korea	3,591	70.6	75.9

Source: Ministry of Planning

Pakistan has one of the lowest MVA per capita in Asia at US\$58. Share of Medium & High Tech Goods in Manufacturing is also at lowest 10.1%, which show that Pakistan still has large scope to grow in manufacturing sector.

Issues Affecting Growth

Following are the bottlenecks identified by Ministry of Planning:

Saturation of Capacity: in key sub-sectors such as steel, automobiles, fertilizer, cement, paper and paper board, chemicals.

Skills: Pakistan faces both a skills shortage, and skills gap in key modern technologies reducing optimum operation of plant and machinery.

Energy Shortages and Unreliability: This forces firms to generate their own power which can tie up more than 10% of the capital, while power outages are estimated to cost nearly 6% in terms of annual production.

Transport and Communication Infrastructure: The growth in the last few years has placed great strains on an ageing infrastructure which is best highlighted by the spurt in sale of automobiles and motorcycles, resulting in a clogged road network.

Certification and Standards: The Midterm Development Framework (MTDF) 2005-10 has emphasized infrastructure and facilities for proper certification of quality, safety, and reliability.

Productivity Levels: Productivity is still inadequate to meet global trading challenges. Special efforts are underway to enhance skills and numbers through a holistic.

Policies and Strategies:

Pakistan is implementing important strategic choices to ensure sustainable growth in the manufacturing sector amidst a rapidly changing and challenging international competitive environment. This involves a shift in the production paradigm to knowledge based industrialization.

The inefficiencies of import substitution are already giving way to an export led strategy, as is evident from surging exports. The private sector is the key part-taker in the growth strategy, while the role of public sector would be that of a facilitator and regulator to ensure a competitive market structure. According to Ministry of Planning, a growth rate of 8.6% has been targeted or the manufacturing sector including 9.0% for large scale manufacturing and 9.3% for small and medium enterprises (SMEs).

In summary, Pakistan's manufacturing sector is set for healthy growth in vicinity of 10% in real term, in years to come. Its share in GDP should be maintained around 19% to 20% and for export around 80% to 85%.

Banking Sector

The financial sector in Pakistan comprises of Commercial Banks, Development Finance Institutions (DFIs), Microfinance Banks (MFBs), Non-banking Finance Companies (NBFCs) (leasing companies, Investment Banks, Discount Houses, Housing Finance Companies, Venture Capital Companies, Mutual Funds), Modarabas, Stock Exchange and Insurance Companies.

At present there are 26 scheduled banks, four specialized banks, nine DFIs, six MFBs, seven Islamic banks and 23 NBFCs operating in Pakistan whose activities are regulated and supervised by State Bank of Pakistan.

Regulations

As per information available with State Bank of Pakistan (SBP), SBP itself regulates Banks, Development Finance Institutions (DFIs), and Microfinance Banks (MFBs), while authorities such as Securities and Exchange Commission and Controller of Insurance monitor the rest of the financial institutions.

Relevant Acts:

- Banking Companies Ordinance, 1962.
- State Bank of Pakistan Act, 1956
- Bank's Nationalization Act, 1974,

All these acts give power to SBP to carry out inspection and supervision of the banks. The State Bank of Pakistan can exercise the following powers vested upon it under the Banking Companies Ordinance:

- Prohibiting the bank from giving loans, advances & credits.
- Prohibiting the bank from accepting deposits.
- Cancel license of a bank, give directions to the bank as it deem fit.
- Remove chairman, directors, chief executive or other managerial persons from the office and appoint a person as chairman, director or chief executive.
- Extreme steps such as- winding up the bank through high court and applying to Federal Government for an order of moratorium in respect of a bank and to prepare scheme of reconstruction or amalgamation.

As per information available with SBP, The State Bank is empowered to determine Statutory Liquidity and Cash Reserve Requirements for banks/DFIs. At present, Cash Reserve Requirements is Average 7%-Minimum 4% on Demand Liabilities and Average

3% - Minimum 1% of Time Liabilities. In addition to that banks are required to maintain Statutory Liquidity Requirement (SLR) at 15% of their Time & Demand Liabilities. Similarly, DFIs are required to maintain SLR of 14% and Cash Reserve of 1% of their specified liabilities. In addition,, the Banking Companies Ordinance was amended in 1997 that empowers the State Bank to prescribe capital requirements for banks. In exercise of these powers the State Bank has laid down Minimum Capital Requirements for banks based on Basel capital structure. The banks have to maintain a Capital Adequacy Ratio in a way that their capital and unencumbered general reserves are, at the minimum, 8% of their risk weighted assets, and effective from 1st January, 2003 banks are required to maintain a minimum paid up capital level of US\$16.6mn.

Islamic Banking in Pakistan

The Islamic financial services industry, comprising Islamic banking, Islamic insurance (takaful) and the Islamic capital market, is an area that has grown to become an increasingly substantial segment within the global financial market and has gained considerable interest as a viable and efficient alternative model of financial intermediation. Growing awareness of and demand for investing in accordance with Shariah principles on a global scale have been the catalyst towards making the Islamic financial services industry a flourishing industry. This is also a reflection of the increasing wealth and capacity of investors, both Muslim and non-Muslim, to seek and invest in new investment products that serve their needs.

In general, Islamic companies/banks are characterized by the following features:

- Transactions that are free from the payment and receipt of a fixed or predetermined rate of interest
- Transactions that are based on profit and loss sharing (PLS) arrangements where the rate of return is not fixed prior to the undertaking of the transactions.
- Business activities and investments those are undertaken on the basis of permissible activities.
- Transactions those are free from elements of gharar (unreasonable uncertainty).
- Payment of Zakat (alms or taxes) by the bank.
- Transactions that operate through Shariah-compliant modes of financing

Table 22: Islamic Banking Players

	Dec-03	Dec-04	Dec-05	Jun-06	Sep-06
No. of Banks	1	2	2	4	4
No. of Branches	10	23	37	48	66
No. of Conventional Banks	3	7	9	11	11
Operating Islamic Banking Branches	7	21	33	39	47

Source: SBP

As per information available with SBP, there are currently four Islamic banks in Pakistan. Total deposits with Islamic banks are estimated to be US\$1bn (PKR66bn). Internationally, Islamic banking is the fastest growing part in banking sector and is believed to grow at a rate more than 15% p.a. Assets of Islamic banks worldwide are believed to be about US\$450-550bn.

Table 23: Profitability of Islamic Banks

<i>Figures in US\$ mn</i>		
Bank	Net Profit 2006	Net Profit 2005
Bank Alfalah	28.9	28.0
Meezan Bank	10.1	6.9
Al Baraka	NA	5.7

Source: Financial Statements of the Companies

Policies adopted by SBP

The central bank has allowed three types of Islamic banks to operate:

- Full fledged Islamic banks: Under this policy SBP has issued detailed criteria for setting up of scheduled Islamic commercial banks.
- Subsidiaries of conventional banks: Under this policy scheduled commercial banks are allowed open subsidiaries for Islamic banking operations.
- Stand alone windows: Under this policy, criteria are laid down for the existing commercial banks for opening the stand alone branches for Islamic banking.

All these promotional measures are likely to see surge in number of Islamic banking branches available to Pakistani people. Thus, we should see increased availability of the competitive products in Islamic banking in Pakistan.

Commercial Banks in Pakistan

The banking sector in Pakistan has gone through a comprehensive and complex process of restructuring since 1997. The objective has been to make these institutions financially sound and to strengthen their links with the real sector for promotion of savings and investment.

Commercial banks operating in Pakistan can be divided into four categories:

1. Foreign Banks.
2. Nationalized Commercial Banks (NCBs)
3. Privatized Banks
4. Private Banks

According to information available with Pakistan Economist, SBP follows a supervisory framework, CAMEL, which entails the analysis of six indicators reflecting the financial health of financial institutions. Following are the indicators: 1) Capital Adequacy, 2) Asset Quality, 3) Management Soundness, 4) Earnings and Profitability, 5) Liquidity and 6) Sensitivity to Market Risk.

Table 24: Banking System Financial Indicators

<i>Figures in percent (unless otherwise mentioned) for all the scheduled banks</i>	Dec-2001	Dec-2002	Dec-2003	Dec-2004	Dec-2005	Jun-06	Sep-06
Capital							
Capital Adequacy Ratio	8.8	8.8	8.5	10.5	11.3	11.9	12.7
Tier 1 Capital to Risk	7.3	6.2	6.5	7.6	8.3	8.9	9.8
Weighted Asset							
Capital to Asset Ratio	3.8	4.8	5.5	6.7	7.9	8.1	8.8
Asset Quality							
NPLs/ total loans	23.4	21.8	17.0	11.6	8.3	8.0	NA
Provision against problem loans/Problem loans	54.7	60.6	63.9	70.4	76.7	75.3	NA
Profitability							
RoA	-0.5	0.1	1.0	1.2	1.9	2.1	NA
RoE	-12.6	3.2	20.0	20.3	25.8	26.5	NA
NII/gross income	70.4	67.1	59.2	62.8	72.0	NA	73.2
Liquidity							
Liquid asset/total asset	38.5	46.7	45.1	36.6	33.7	34.1	NA
Liquid asset/total deposits	50.7	61.8	58.5	46.5	43.5	44.5	NA

Source: IMF (Pakistani Authorities) and SBP

Capital adequacy

The banks in Pakistan are required to maintain 8% capital to Risk Weighted Assets (CRWA) ratio as per Basel II requirement. Banks were required to achieve a minimum paid-up capital to US\$8.3mn by end of Dec-98, according to Pakistan Economist. This requirement was subsequently raised to US\$16.6mn and banks were given a deadline up to 1 Jan-03 to comply with this. Capital adequacy ratio for Pakistan has been improving consistently; from 8.8% in 2001, it rose to 11.9% by Jun-06. Similarly capital to asset ratio also improved from 3.8% in 2001 to 8.1% by Jun-06.

Asset quality

The ratio of net NPLs to net advances, an indicator of asset quality, for all banks has declined, from 23.4% in 2001 to 8.0% in Jun-06 for all the scheduled banks. Ratio of provision against problem loans/problem loans has gone up, from 54.7% in 2001 to 75.3% in Jun-06 for all the scheduled banks. This indicates significant improvement in the asset quality of banks over last five years.

Management soundness

It is difficult to judge management soundness by looking at the financial statements of the banks as it is a qualitative issue. However, parameters to judge it are such as return on total assets (ROTA), total expenditure/total income, operating expenses/total expenses.

Earnings and profitability

The most commonly used indicator are ROA and ROE. ROA and ROE have improved markedly from -0.5% and -12.6% respectively in 2001 to 2.1% and 26.5% respectively in Jun-06.

Liquidity

Liquidity in balance sheets of the banks has been on a constant decline since 2002. This reflects the monetary policy changes by the SBP to manage the crisis-like situation created after 1998. Ratio of liquid assets to total assets came down from 46.7 in Dec-02 to 34.1 in Jun-06 and Liquid assets to total deposits came down to 44.5% in Jun-06 (61.8% in Dec-02).

CRR was increased in Jul-06 to Average 7%-Minimum 4% on Demand Liabilities and Average 3% - Minimum 1% of Time Liabilities.

Table 25: Accounts of Scheduled Banks

<i>Figures in US\$ mn</i>	Jun-05	Dec-05	Jun-06	Dec-06	Y-o-Y change on Dec-06
Net Foreign Assets	2,212.0	1,648.1	2,072.5	1,941.5	17.8%
Claims on Non-Residents (Foreign Assets)	2,732.9	2,173.2	2,543.5	2,456.4	13.0%
Less: Liabilities to Non-Residents (Foreign Liab)	520.9	525.1	470.9	514.9	-1.9%
Claims on Central Bank	3,871.8	4,145.7	4,149.3	5,048.3	21.8%
Net claims on General Government	7,787.7	6,550.9	7,123.8	6,087.3	-7.1%
Net claims on central government	8,784.0	7,516.8	8,210.5	7,584.4	0.9%
Less: Liabilities to central government	2,117.7	2,327.4	2,622.7	2,736.4	17.6%
Net claims on provincial governments	-996.3	-966.0	-1,086.6	-1,497.1	55.0%
Claims on provincial governments	565.2	586.5	887.3	581.4	-0.9%
Less: Liabilities to provincial governments	1,561.5	1,552.4	1,973.9	2,078.5	33.9%
Claims on other sectors	29,927.3	35,052.2	36,432.5	40,427.6	15.3%
Liabilities to central bank	3,177.1	3,230.6	3,359.8	4,211.2	30.4%
Deposits included in broad money	38,448.4	41,345.7	44,393.8	45,948.8	11.1%
Transferable deposits (Demand deposits)	30,861.3	29,156.5	32,974.1	32,603.0	11.8%
Other deposits (Time deposits)	7,587.1	12,189.1	11,419.8	13,345.8	9.5%
Securities Other than shares included in broad money	-	-	-	-	-
Deposits Excluded from broad money	500.9	821.8	907.9	1,054.0	28.3%
Securities Other than shares excluded from broad money	-	-	-	-	-
Loans	416.7	802.6	2,758.2	2,633.4	228.1%
Financial Derivatives	-	-	-	-	-
Trade Credit & Advances	-	-	-	-	-
Central Govt lending fund	156.0	156.1	154.8	153.3	-1.8%
Shares and Other equity	3,375.5	3,785.4	4,094.1	5,220.5	37.9%
Other items (net)	-2,277.7	-2,746.9	-5,891.8	-5,717.6	NM

Source: SBP

NM: Not meaningful

The main observations are that until Dec-06 on Y-o-Y basis:

- Net foreign assets increased by 17.8% to reach US\$1,941.5mn
- Claims on central bank increased by 21.8% to reach US\$5,048.3mn
- Claims on central government increased by 0.9% to reach US\$7,584.4mn
- Claims on general government decreased by 7.1% to reach US\$6,087.3mn
- Total loans increased by 228% to reach US\$2,633.4mn

Deposit Mobilization

Deposit mobilization has been improving since 2002. Deposits as a proportion of GDP have been maintained around 40% for last few years. Growth rate of overall deposits have been healthy at 18.3% over 2002-06.

Table 26: Deposits of Scheduled Banks

<i>In US\$ bn</i>	2002	2003	2004	2005	2006	CAGR
	25.5	31.0	37.2	44.6	49.9	18.3%
% of GDP	34.8	37.2	38.3	40.4	38.9	-

Source: SBP

Pakistani banks experienced increasing share of foreign currency deposits in their balance sheets until early 2000s. In order to prevent this phenomenon, SBP made it compulsory for the banks to not to have foreign currency deposits more than 20% of their rupee deposits from 1 Jan-02.

Credit extension

As a result of easing in SBP's policy in recent years, credit extension has exceeded deposit mobilization. This is reflected in advances growing at CAGR of 24.6%, which is much faster than growth in deposits (18.3%).

Table 27: Advances of Scheduled Banks

<i>In US\$ bn</i>	2002	2003	2004	2005	2006	CAGR
	16.7	20.2	27.3	34.2	40.0	24.6%
% of GDP	22.7%	24.3%	28.2%	31.1%	31.2%	-

Source: SBP

Banking spreads

During 1998 to 2004 there had been a declining trend both in lending and deposit rates. Downward trend in lending rates was a result of SBP policy. On the back of rising inflation, the trend was reversed with rise in rates in 2005 & 2006.

Table 28: Banking Spreads

<i>Figures in %</i>	Yield on assets	Cost of liabilities	Spread
CY1998	14	8.5	5.4
CY1999	12.7	7.7	5
CY2000	11.3	6.6	4.7
CY2001	11.3	6.1	5.2
CY2002	8.9	4.3	4.6
CY2003	5.8	2	3.8
CY2004	5.1	1.5	3.6
CY2005	7.7	2.6	5.1
Nov-2006	NA	NA	7.4

Source: SBP

CY: Calendar Year.

The declining trend in lending rates was in line with monetary objectives of SBP, as a result lending rate came down from 14% in 1998 to 5.1% in 2004. Rates were hiked to 7.7% in 2005. Interest rates on deposits also followed the similar trend, falling from 8.5% in 1998 to 1.5% in 2004, before rising to 2.6% in 2005. Banking spreads has been on rise since last two years, increasing from 3.6% in CY2004 to 7.4% in Nov-06.

Moody upgrades the rating...

Moody recently upgraded, the BFSR (Bank Financial Strength Rating) of four Pakistani banks- MCB Bank, National Bank of Pakistan (NBP), United Bank Limited, Habib Bank Limited by 1 notch, which according to Moody's reflects their increasingly stronger financial fundamentals & their evolving local franchises. BFSR rating evaluates the stand alone or intrinsic financial strength of the bank without considering external support factors.

Outlook...

The government borrowing from SBP and commercial banks came down substantially and private sector borrowing increased 2001-2002 onwards.

Commercial banks have gone through the process of restructuring. The SBP has been successful in implementing its policies. Most of the banks have been able to adjust to new working environment.

Commercial banks have done well in recent years. Out of the total number of commercial banks 22 are listed and these banks are doing better than their non-listed counterparts. The total net earning of the listed commercial banks touched PKR60bn or approximately US\$1bn in December 2006, compared to PKR45bn or US\$750mn a year ago. spread, on average, has increased by 110 basis points to 7.4% in 2006, which is significantly higher than that of whole banking sector of less than 6%.

Interest expense to interest income ratio of listed banks also increased to 45% versus 36% previously. Non-interest income of the bank, mainly on the back of higher dividend income and fee-income, soared by 29% to PKR4bn.

In summary, Pakistan banking sector is due for a healthy growth in line with the overall economy.

Insurance...

Pakistan's insurance industry is growing fast and the government is paying attention to it with introduction of new legislation/amendment in the old one. Recently, the government decided to bring Postal Life under the circle of the Insurance Ordinance 2000. The sector has 60 companies including local and foreign companies that deal in life, health and general insurance. However, the market is dominated by three government-owned companies-The State Life Insurance Corporation, the Pakistan Reinsurance Company and the National Insurance Company Limited.

As per the information available with Privatization Barometer, direct insurance premiums amounted to PKR52.2bn (US\$860mn) in 2006, up by 22%. According to the new policy, State Life will be converted into a private limited company and partly privatized, however, it will remain owned by the government.

As per the information available with Associated Press of Pakistan, premium insurance penetration has improved albeit it is still very low (0.67% of GDP), especially in the area of life insurance where Pakistan has a much lower penetration (0.27% of GDP) as compared to India (2.53% of GDP) and even Bangladesh (0.42% of GDP).

Table 29: Net profit of Top Insurance Companies

<i>Figures in US\$ mn</i>		
Company	2006	2005
Adamjee Insurance	26.0	19.5
EFU Insurance	12.5	8.5
Pak Reinsurance	NA	10.0
Shaheen Insurance	0.8	0.9
Silverstar Reinsurance	NA	0.4

Source: Financial Statements

The profitability of the major insurance companies is on rise and we believe the trend would continue in foreseeable future. The government focus on improving the sector and increasing awareness and improving income among the general public of Pakistan should lead to high growth in the sector in the years to come.

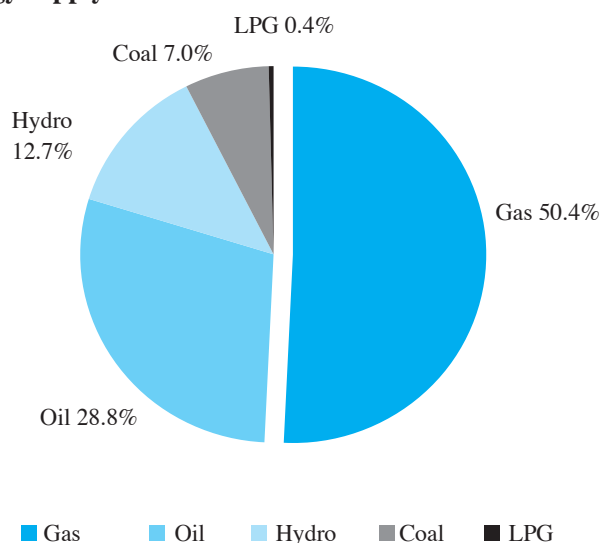
Energy Sector

The petroleum sector has witnessed unprecedented fluctuations in crude oil prices during last decade, dropping to less than US\$10 per barrel in 1998 and increasing over US\$75 per barrel in Jul-06 resulting in severe economic impact on global economy. It had adverse effect on Pakistan as its energy requirements are dependent upon oil and gas as primary energy sources. The share of the imported oil has been reduced significantly as a result of government's efforts to shift various energy consuming sectors from oil to natural gas and coal fired system, however, the limited production of natural gas has not allowed the country to fully wean of imported oil.

An overview of energy resources

According to information available with government of Pakistan, its primary energy supplies for the year 2005-06 amount to 57.9 million tons of oil equivalent (TOE). The country's energy demand far exceeds its indigenous supplies. Oil and gas form the bulk of primary commercial energy supply mix of Pakistan, contributing 79.6% (oil: 28.8%, gas: 50.4%, LPG: 0.4%). The other sources include; coal: 7.0%, hydro electricity: 12.7% and nuclear electricity: 0.6%. Oil import bill in the fiscal year was US\$6.7bn.

Figure 16: Energy supply in Pakistan



Source: Ministry of Petroleum & Natural Resources

Oil

In past, the country had been dependent on oil imports, as it is today to a great extent. According to Ministry of Petroleum, the crude oil import for the year 2005-06 was about 8.6mn tons. This accounts for an equivalent to US\$3,803mn and that of petroleum products import was 6.0mn tons an equivalent of US\$2,849mn. The total annual import bill for the year 2005-06 was US\$6,652mn. Annual oil refining capacity is 12.9mn tons. It gets most of its oil imports from the Middle East Countries.

Pakistan has large and prospective basin (onshore and offshore) with sedimentary area of 827,268 sq. km. So far about 883mn barrels crude oil reserves have been discovered of which 559mn barrels have already been produced, according to Ministry of Petroleum. A potential of total reserves of hydrocarbons has been estimated as 27bn barrels of oil and 282trn cubic feet (TCF) of gas. Till now over 653 exploratory wells have been drilled by various explorations (including national and international ones) and production companies, resulting in more than 180 oil and gas discoveries. According to Ministry of Petroleum, indigenous production of crude oil during the year 2005-06 was more than 65,000 barrels per day.

Sectoral oil consumption during the year 2005-06 was: Power (29%), transport (56%), agriculture (0.6%), industry (11%), domestic (0.9%) and government (2.5%).

Natural Gas

Pakistan is one of the most gas dependent economies of the world. According to Ministry of Petroleum, natural gas was first discovered in 1952 at Sui in Baluchistan province which proved a most significant and largest gas reservoir. After successful exploration and extraction, it was brought to service in 1955.

Pakistan has discovered about 52.7 TCF of gas reserves so far, of which 20.2 TCF have already been produced, according to Ministry of Petroleum. Natural gas production during 2005-06 was about 3.8bn cubic feet per day. Pakistan has well developed and integrated infrastructure of transporting, distributing and utilizing natural gas with 9,257 km transmission and 74,186 km of distribution and service lines network developed progressively over 50 years.

Sectoral consumption of natural gas during 2005-06 was as follows:

Power (40.2%), fertilizer (16.2%), cement industry (1.3%), general industry (22.8%), domestic (14.0%), commercial (2.4%) and Transport (CNG; 3.2%).

CNG powering the transport...

As per information available with Ministry of Petroleum, Pakistan started Compressed Natural Gas (CNG) as a transport fuel programme through establishment of research and demonstration CNG refueling stations by Hydrocarbon Development Institute of Pakistan (HDIP) at Karachi in 1982 and at Islamabad 1989. CNG has been successfully substituting oil for last few years. According to Ministry of Petroleum, Pakistan is third largest user of CNG in the world after Argentina and Brazil. For economic and environmental reasons, large diesel vehicles (buses and trucks), the major consumer of High Speed Diesel (HSD) are now next target for substitution by CNG

Coal

As the country has large reserves of coal, it hopes to use coal as an alternative to imported oil. At present coal constitute only 7.0 % of Pakistan's primary energy supplies. According to Ministry of Petroleum, total coal resource potential of Pakistan is estimated

to be around 185bn tons, out of which about 175bn tons are located in Thar desert, Sindh province which is the 5th largest single coal field in the world. Historically the coal consumption in Pakistan has come down with increase in gas consumption. There is a great scope for large scale utilization of coal in power generation.

As per information available with Ministry of Petroleum, Coal consumption during 2005-06 was: Brick kilns (54.7%), Cement and other industry (36.0%), Power (1.9%), Coke use (7.3%). At present the brick industry is the biggest user of coal, consuming about 4.2mn tons annually. Coal briquettes could also find a ready market in domestic sector. An extensive campaign to utilize huge indigenous coal resource to meet ever-increasing national energy needs is on way.

Table 30: Production of Petroleum, Oil & Lubricants (POL) Products

<i>Figures in thousand metric tons</i>	FY05	FY06	Y-o-Y Change in FY06 (%)
Jet Fuel	1,127.2	1,259.1	11.7
High Speed Diesel	3,440.5	3,300.2	-4.1
Motor Spirits	1,333.0	1,195.4	-10.3
Furnace oil	3,132.7	3,377.3	7.8
Naphtha	724.4	883.6	22.0
Petroleum Products	655.7	650.0	-0.9

Source: SBP

Production for most of the category has gone up during FY06, except for high speed diesel and motor spirits that declined by 4.1% and 10.3% respectively to reach 3,300.2 thousand metric tons and 1,195.4 thousand metric tons respectively.

Opportunities

Gas discoveries and the preference of use of gas over oil, for environment reasons, is bringing in opportunities in the countries which did not have the gas resources or were using the gas sparsely. Global gas reserves have more than doubled over the past 20 years outpacing more than the 60% growth in oil reserves over the same period. Reserves have grown rapidly in former Soviet Union and in developing countries in the Middle East, South and Central America and the Asia-Pacific region. Area of interest for Pakistan would be Middle East, UAE, Saudi Arabia, Africa and Central Asian States. Generally, the developed countries of the world, which have the mature gas industries, do not like to go into the downstream side of the industry as the investment levels are not sufficient.

Pakistan having a large network of gas distribution and availability of a massive skilled man power in downstream gas industry can available the opportunity of exporting the man power in the countries which have launched plans for expansion of the downstream natural gas industries. We believe that demand for energy is going to increase at rapid pace with growth in the economy. In this view exploration and natural gas companies are going to do better in years to come.

Wholesale & Retail Trade

The government has conducted the Economic Census (in year 2005), which shows there are 3.25mn trade and economic activities related establishments all over Pakistan. Out of this about 46% are located in villages of Pakistan.

The sector contributes 19.2% of GDP and provides employment to 14.7% of the people employed in Pakistan. Value added in wholesale and retail trade grew by 8.0% in FY2004, up from 5.9% in FY2003, reflecting recovery in domestic economic activity, acceleration in imports, and continuing double-digit increases in exports.

Table 31: Wholesale & Retail Trade

	FY2003	FY2004	FY2005	FY2006
Percent Share in GDP	18.0	18.2	18.6	19.2
Wholesale & Retail Trade (Growth % in real terms)	5.9	8.4	11.1	9.9
Real GDP Growth (in %)	4.7	7.5	8.6	6.6

Source: SBP

The sector's growth has outpaced the overall economy growth after the period of 1990s. In order to increase trade with the partner countries the government of Pakistan has undertaken several policy reforms:

Table 32: Trade Policy Reforms

Category	Status
Import/Export Regimes	Liberalized
CCI & E Department	Abolished
Import Licensing	Abolished
License Fee at 6%	Abolished
Import/Export Registration	Abolished

All these reforms coupled with growing worldwide economy have resulted in increase trade in Pakistan economy and we opine that the trend is likely to continue in foreseeable future.

The government also took several tariff reforms in order to enhance trade:

- Top rate brought down to 25% (from 120% in 1985)
- Number of slabs reduced from 42 in 1985 to 16 in 1995, 7 in 1999 and 5 in 2005.
- Discriminatory SRO Regime eliminated
- Level playing field provided by tariffication of concessional duties.
- SMEs' access to low tariff raw materials enhanced.
- Duties on hundreds of tariff lines comprising industrial inputs i.e. raw materials and capital goods gradually reduced to 0-5%

- Para-tariffs abolished i.e. import surcharge, regulatory duties, flood relief surcharge, etc.
- Tariff discrimination between commercial and industrial imports eliminated

Besides this, major trade policy initiatives taken by the government are:

- Establishment of Technology Up-gradation Fund
- Launching Enterprise Capacity Building Scheme
- Improving Country's Business Image
- Freight Subsidy—Inland and Offshore
- Establishment of zones for agri - products and fisheries
- Establishment of Special Export Zones
- Establishment of Garment Cities
- Rehabilitation of Industrial Estates
- Establishment of Combined Effluent Treatment Plants
- Facilitation of Garment Exports through Textile Garment Package
- Incentivizing export of Horticulture Products
- Encouraging Women Entrepreneurs
- Opening Land Route Trade with Afghanistan
- Strengthening Trade Diplomacy
- Attracting Buyer Driven FDI for Export Sourcing from Pakistan
- Zero-Rating of Sales for Textile Chain
- Support for Quality Assurance and Lab Accreditation
- Strengthening of SMEs Industrial Clusters
- Relocation of Industries to Pakistan

With significant attention given by the government and overall growing economy resulting in increasing purchasing power of the consumers, the sector is likely to do very well in coming years. In foreseeable future, wholesale and retail trade will benefit from double-digit rises in imports and exports. It is likely to grow by more than 10% in current year.

Auto & Transport

The transport is central to development. It is necessary to get access to jobs, health, education and other amenities, without which quality of life suffers. It is imperative for access to resources and markets, without which growth stagnates and poverty reduction cannot be sustained.

The faulty transport services and infrastructure inefficiencies have been costing annually US\$2.5bn to the government of Pakistan. This also results in low quality of service hampering competitiveness of Pakistan trade.

In the past few years Pakistan has witnessed a huge growth in the demand for automobiles due to easy availability of auto financing facilities and steady government policies. In order to encourage healthy competition in the private sector, the government has also significantly reduced import duty on wholly assembled cars. As the demand for automobiles in the market is rising, the local automobile assemblers are starting to investing heavily in order to increase production capacities.

Policies and Plans

- A plan for declaring the informal transport sector an industry is being finalised, and the proposed plan calls for setting up small as well as large companies, which would qualify for soft loans from banks and tariff incentives from the tax authorities. The sector have been assured that once it is converted into formal industrial sector, the government would ask banks to offer soft loans with little mark up rates.
- The government may also come up with a scheme to buy all trucks operating to replace them with the modern ones for meeting the international standards in view of National Trade Corridor Programme. The modernisation of the trucking sector would reduce 15% to 20% fuel consumption and road maintenance by US\$1bn.
- The strategy has been targeted to increase the share of prime movers from 5% to 10% by June 2010.
- Pakistani government has introduced a five-year Auto Industry Development Plan (AIDP) aiming to increase local production of cars from 200,000 in fiscal year 2005-06 to 500,000 in 2011. The development plan will help make local auto industry more competitive, create capacity for local design and innovation, domestic competition, human resource development and auto cluster development.
- Pakistan Railways would build Circular Railways in Karachi at a cost of US\$1bn, according to Minister for Railways. The project would include laying of 20 km new track besides up-gradation of the 30 km existing track around the Megapolis.

Regulation

Tariff Based System (TBS) for Automotive Sector:

As of July-06, the deletion programs for the Automotive Sector have been replaced by the Tariff Based System (TBS). The deletion programs have gradually been phased out under the WTO regime to make Pakistan TRIMs compliant.

The TBS has been developed with the following main objectives:

- To preserve & to promote the technologies that have been developed in the country
- To protect the present job structure in the auto sector.
- To promote new investment

The industry

Tractors:

Al Ghazi, the leader in the segment produced 26,076 tractors during the year 2006 and 26,250 delivered compared with 22,430 in 2005. While achieving these records the Company retained market leadership, increased market share to 53%.

As per the information available with Al Ghazi Tractors Ltd., Pakistan, bank loans used to account for 99% of tractor sales a few years ago which have now been reduced to less than 20% this year. The annual meeting of the Agricultural Credit Advisory Committee approved a target of US\$2.6bn for the disbursement of agricultural credit to the farmers during the fiscal 2006–07 which is 35% higher than the provisions for the last fiscal. The banks are expected to trickle down the allocation and increase disbursement of loans for tractors.

Cars:

As per the information available with Indus Motor Company Ltd., Pakistan, the overall nation-wide sales of locally assembled passenger cars and light commercial vehicles for the six months ended December 31, 2006 grew by 7.4 % to 92,332 units, compared to 86,000 units for the same period last year. Total production of CKD units for the period was approximately 94,818 units, up 7.8 % over the six months ended December 2005. Due to liberalization of the trade policy, 46,275 units of used vehicles were imported during 2005-06 as compared to 6,266 units in 2004-05, representing an increase of 639%, while an additional 13,166 units were imported in the first six months of FY07. The import of used cars at the current level is hurting the sale and production of locally manufactured automobiles especially at a time when the domestic auto makers and its vendors are investing heavily in capacity expansions to meet the customer demand.

Table 33: Production in Automobile Industry

	FY05	FY06	Y-o-Y change in FY06 (%)
Cars more than 1,300cc	53,568	69,867	30.4
Cars less than 1,300cc	72,820	90,775	24.7
Jeeps & Vans	7,524	12,901	71.5
LCVs	23,928	32,053	34.0
Trucks	3,292	4,518	37.2
Buses	1,763	825	-53.2
Tractors	43,200	48,887	13.2

Source: SBP

Production in automobile industry showed huge increase during FY06. Cars production in more than 1,300cc category showed jump of 30.4% and that in less than 1,300cc showed improvement of 24.7% on Y-o-Y basis. Jeeps & Vans production were up by maximum of 71.5%, while, LCVs and Trucks showed increase of 34.0% and 37.2% respectively. Buses were the only category to register decline of 53.2%.

Challenges Faced by The Automobile Sector

- Global warming: Countries such as Pakistan stand to suffer most as a consequence of this change, with estimated costs in the range of about a few percentage points of gross domestic product (GDP)— several times greater than the relative effect on industrialized countries such as USA, UK etc.
- Air pollution: The greatest environmental concern about urban transport in most cities relates to local air pollution. To address this Pakistan would need to make appropriate changes in its vehicle and fuel policy.
- Noise pollution: The levels experienced in developing-country streets, is below the lower limits above which noise is considered an occupational hazard. However, it is an area where the industry would need to pay attention to improve acceptability among the consumers.

Cleaner Production Opportunities in Pakistan's Automotive Industry

Contributing to a better environment...

The approach of the industry has changed towards the cleaner production techniques used today by making a few changes in the existing production processes in the manufacturing units. The thrust has been on reducing the pollution levels at the first stage.

Business sense...

Local Automotive manufacturing industry is the major supplier to the transport sector of Pakistan. The automotive industries of the country are involved in the manufacturing of buses, trucks, tractors, jeep, light commercial vehicles, cars, motorcycles and rickshaws. According to information available with "cpp.org.pk"(CPP- Cleaner Production

Program) the local content of the vehicle produced ranges from 27% to 60% in cars and light commercial vehicles. With the possibility of implementation of Kyoto protocol, there is need on the part of the automotive manufacturers to pay attention to the global health of environment and implement cleaner production techniques.

The growth in the transportation sector is imminent, which offers profitable investment opportunities for the businessmen keen to make investment in auto and transport sector of Pakistan. The factors such as the growth in the road networks and highways in Pakistan, construction of Gwadar Port and improvement in relations with India are likely to boost transport sector.

Housing & Cement Sector

Housing

Housing Sector is one of the biggest asset classes in Pakistan and it provides a great opportunity to reviving economic activities because of its backward (materials such as Brick, Cement, Steel) and forward (credit & financing, advertising) linkages with the economy of the country. The sector has the potential to create employment opportunities besides giving impetus to industry, commerce and trade. The government, declared Housing and Construction as a priority industry (National Housing Policy–2001), owing to its importance in the overall economic development of the country.

The government is committed to give priority to housing sector and has demonstrated its commitment by allocating significant resources for its accelerated development, which would boost the economic activities in allied industries.

Regulation and Policies

The National Housing Policy was approved by the President on Jun-01. The major emphasis of the policy is on mobilizing resource, availing land, providing incentives for homeownership, and to developers and constructors. The objective of the policy is to create affordable houses, specially for the middle and low income groups.

To facilitate the agenda of development of housing, the National Housing Authority (NHA) was established in Aug-87. The NHA was declared as an attached department of Ministry of Housing and Works on Jun-2000.

According to information available with government of Pakistan, following are the Terms of Reference (TORs):

1. To advise on the implementation and monitoring of National Housing Policy 2001.
2. To identify and make recommendations to resolve issues hampering housing & construction activities.
3. To assist in formulation of mechanism to:-
 - i) Attract local and foreign investment in housing sector.
 - ii) Measure fixed investment in the sector and its employment effect.
4. To advise and recommend legislation to:-
 - i) Regulate the Housing Sector/Societies/Companies etc. to check mal-practices being adopted to fleece the general public.
 - ii) Curb land speculation.

Current Projects in the Sector

Emaar Properties, one of the leading property developers, announced three real estate developments in the cities of Islamabad and Karachi in Pakistan. The projects, with entail a total investment of US\$2.4bn. Emaar's two projects in Pakistan: the Highlands and Canyon Views will be in Islamabad. Karachi will be home to Crescent Bay, a 75-acre development.

Foreign Investments: Pakistan and China have entered a five-year economic and trade cooperation framework to increase Chinese investment in the South Asian country. Real estate, have been identified as one of the target sectors for Chinese investors so that the country's industrial production can be enhanced.

The FTA covers investments, including investment promotion and protection, liberalization of trade in goods, treatment of investment, expropriation, compensation for damages and losses, and dispute settlement. The deal is expected to enhance economic cooperation between the two countries.

According to Asia Times (AT), one of the leading Chinese daily, some 20 Chinese companies have committed to investing in the recently proposed Pak-China Industrial Zone, near Kala Shah Kako in the province of Punjab. This would be the first Chinese industrial zone outside China in which leading Chinese groups would make investments and establish various projects. China International Industry and Commerce Co Ltd (CIIC) has shown interest in constructing more than 10,000 houses for low-income groups. The CIIC is currently planning the construction of housing units mainly in the capital, Islamabad.

According to AT, in Punjab, about 200 hectares of land at M-III Industrial Estate in Faisalabad has been allocated for Chinese investors. The PKR4.25bn (US\$95mn) M-III, which will be the biggest industrial estate in the country, is being established on about 1,820 hectares.

Cement

Cement manufacturing in Pakistan has been increasing for the last few years. There exists intense competition between members of the cartel of Cement producing units. One of the critical success factors of the industry has become utilization of production capacity.

As per data available in 2005, total No of units were 24, about 20 units were owned by the private sector. Two of the four units in the public sector (Mustehkam Cement Ltd. & A.C. Rohri Cement Ltd.) had to close down their operation due to stiff competition and heavy cost of production.

Improving performance...

According to data available with SBP, the cement industry performed well during H1-FY07. Total sales rose 26.0% Y-o-Y to 11.0mn tons, significantly higher than 12.1% growth seen in the H1-FY06. The remarkable performance of cement sector is attributed to-

- Enhanced installed capacity during the last five years
- Rise in local demand as well as strong external demand

Table 34: Construction Performance Indicators

<i>Figures in US\$ mn except for cement dispatches</i>	FY04	FY05	FY06	Y-o-Y change (%) (FY06)
Value added by construction Industry	1,424.1	1,644.9	1,781.7	8.3
Development Expenditure	2,760.4	3,814.0	6,066.3	59.1
Gross Fixed Investments	135.9	221.1	232.7	5.2
Private Credit For Construction	314.7	526.0	703.0	33.7
FDI	35.4	58.7	136.0	131.7
Cement Dispatches (000' tons)	13,663	16,353	18,412	12.6

Source: SBP

Construction activity has been on upswing for last two years as value added by it went up by 8.3% to reach US\$1,781.7mn. FDI to the industry improved by a huge margin of 131.7% to reach US\$136mn and cement dispatches rose by 12.6% to reach 18.4mn tons.

Major markets for Pakistani cement exports are Afghanistan and the UAE. The key factors for the rise in cement exports during the first six months of FY07 have been restoration of duty drawback on cement exports, exemptions from federal excise duty & sales tax on exported cement and lower domestic prices in H1-FY07.

Following is the summary of performance of the sector:

- The local cement dispatches rose by 25.0% in the first six months of FY07 on Y-o-Y basis compared with 13.4% growth in the same period of FY06.
- Export demand for cement registered a robust increase of 36.8% during H1FY07 as against a fall of 0.2% during H1FY06.

The installed capacity in cement industry was about 20mn tons as on Oct-05. The Central Board of Revenue (CBR) has allowed duty drawback at the rate of PKR25.08 per ton on export of cement through a customs notification by amending the SRO 840 of 2006. The facility is effective, from Sep-06.

The cement and housing sector looks promising as supported by focus of government of Pakistan and various other factors such as increasing demand, increasing purchasing power and disposable income with people of Pakistan which would help in sustaining demand and high proportion of young people in population that would keep or increase the demand in years to come.

Stock Market and Bond Market

Karachi Stock Exchange

Karachi Stock Exchange (KSE) is one of the biggest and most liquid exchanges and was declared as the “Best Performing Stock Market of the World for the year 2002”. As on 31 Jan-2007, 654 companies were listed with the market capitalization of PKR3,077.4bn (US\$50.7bn) having listed capital of PKR516.9bn (US\$8.5bn). The KSE 100 Index closed at 11,272.33 on 31 Jan-2007.

KSE has been into the 6th year of being one of the Best Performing Markets of the world as declared by the international magazine “Business Week”.

KSE started with a 50 shares index. As the market size got bigger and bigger a representative index became the need of the day. On 1 Nov-1991 the KSE-100 was introduced and remains to this date the most generally accepted measure of the Exchange. The KSE-100 is a capital weighted index and consists of 100 companies representing about 90% of market capitalization of the exchange.

Table 35: Market Capitalization and listed companies

Year	No. of Listed Companies	Listed Capital (PKR bn)	Market Capitalization (PKR bn)	Market Cap./Listed Capital
1950	15	0.12	-	-
1960	81	1.0	1.9	1.9
1970	291	3.9	5.7	1.5
1980	314	7.6	9.8	1.3
1990	487	28.0	61.8	2.2
2000	762	236.5	382.7	1.6
2007	654*	516.9*	3,111.6**	5.9

Source: KSE

* as at end of Jan-07

** as at Mar-07

KSE has grown in breadth in terms of listed companies and listed capital. Number of companies has gone up about 80 in 1960 to 654 in 2007. While listed capital has gone up from PKR1.0bn to PKR516.9bn during the period of 1960-2007.

Evolution of KSE

KSE has emerged as the key institution of the capital formation in Pakistan. As per the information available with KSE we have highlighted the evolution of KSE:

- Large number of listed securities: Listed companies 654, securities listed on the exchange 694, out of which ordinary shares are 654, Preference shares are 15 and debt securities (TFCs) are 25.
- Listed capital PKR516.9bn (US\$8.5bn).

- Market capitalization PKR3,077.4bn (US\$50.7bn), as at end of Mar-07. Market Capitalization as percentage of GDP (45.7% as at Jan-07) is still less as compared to other countries in Asia, such as India where it is more than 90%.
- Average daily turnover 168.9mn shares with average daily trade value PKR20.2bn (US\$332.7mn). This indicates high liquidity in the market.
- Membership (broker/agents of the KSE) strength at 200. High degree of membership strength creates competitiveness among the members and provides best deals to the investors in terms of quality of service and prices.
- Corporate Members are 158 out of which 9 are public listed companies.
- Active Members are 163.
- Fully automated trading system with T+3 settlement cycle.
- Deliveries through central depository company. This increases the reliability in the system.
- National Clearing and Settlement System in place.

Table 36: Trade Summary 2003-2006

	2003	2004	2005	2006
Number of listed companies	701	661	661	651
Value traded (US\$ bn)	66.4	83.6	120.1	144.7
Volume traded (mn)	76,380.1	85,640.0	91,449.7	63,046.5
Market Cap. Year End (US\$ bn)	16.5	29.6	46.0	46.0
Market Cap/GDP	19.7%	30.6%	41.7%	35.9%
Turnover Ratio (times)	4.0	3.4	3.5	3.1
% Gain in index over last Year (December to December)	65.5	39.1	53.7	5.1

Source: Karachi Stock Exchange & SBP

The notable observations are:

- Volume traded has decreased significantly in 2006 as compared to 2005. It stood at 63,046mn shares in 2006.
- KSE has high turnover ratio of more than three times, which indicates high liquidity in the market.
- Market cap/GDP ratio has also improved significantly from 19.7% in 2003 to reach 31% at Dec-06, which improved further to reach about 35% as at Mar-07. Nevertheless, market cap/GDP for KSE is still lower as compared other emerging economy.

- KSE index gained 5.1% (Dec-05 to Dec-06) as compared to Bombay Stock Exchange's Sensex, which gained 46.7% during the period and 55.3% for the Indonesian market, and -5.4% for SET-100 of Thailand.

Relevant Rules & Regulations

KSE has enough regulation on markets to protect investor's interest. For instance it has set rules regarding keeping members on KSE, those who are found guilty of providing false information or any criminal deeds are expelled from the KSE membership.

Rules and regulations regarding listing of companies :

- In case capital of company is up to five hundred million rupees, at least 50% of such capital shall be offered to the public.
- In case capital of the company is beyond five hundred million rupees, public offer shall be at least two hundred and fifty million rupees or twenty-five percent of the capital, whichever is higher.
- The allocation of offer of share capital to overseas Pakistanis shall not exceed 20% of the public offer. Provided that in case of under subscription in either of the categories i.e., the quota allocated to resident or non-residents Pakistanis, the unsubscribed portion will be allocated to the applicants of other category.
- Allocation of share capital to employees of a company shall not exceed 5% of the public offer.
- In the case of a Modaraba applying for listing on the Exchange, 30% of the total Paid-up capital shall be subscribed by the sponsors or their associates or friends, relatives and associated undertakings and the balance of 70% shall be offered to the General Public.
- The stock exchange, if it is satisfied that it is not practicable to comply with the requirements of any of the above regulations in a particular case or class of cases; the exchange may, for reasons to be recorded, relax the regulations subject to approval of the Commission.

Impact: These rules regarding listing of companies are meant to provide liquidity to the stock by ensuring enough retail participation and limiting ownership by the employee or management of the companies.

Rules regarding short selling:

1. Short Sell under Ready Market shall take place through the Karachi Automated Trading System (KATS).
2. Blank sells are not permissible.

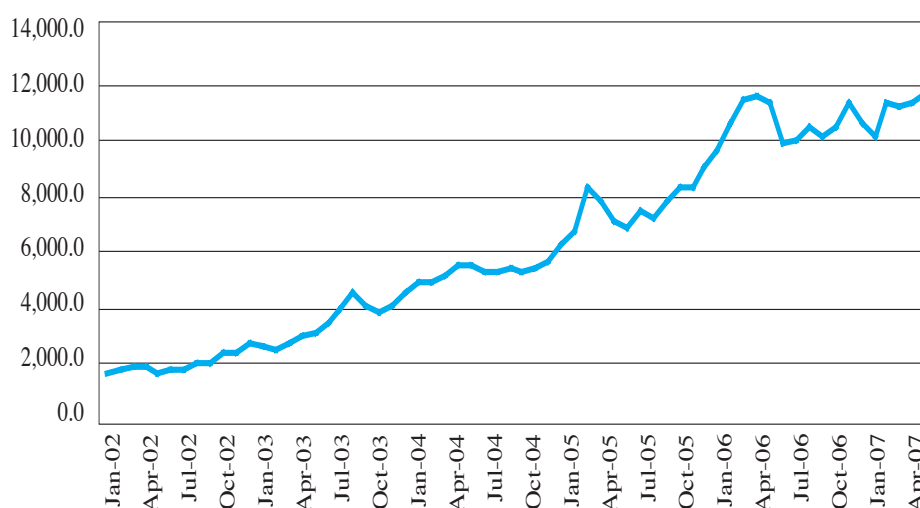
3. Short sell pre-requisite:

No Member shall make a Short Sell unless:

- Prior contractual borrowing arrangement has been made.
- The sale is made at an up-tick, and the trade is identified as a Short Sell at the time of placement of order.
- Short Seller will have to declare short sell transactions while placing the order in the system in the manner and procedure as may be prescribed by the exchange from time to time. This identification would be at the trade level to the exchange, which would then disclose the cumulative figures for public consumption at the close of market everyday.

The rules regarding short-selling are meant to protect investor's interest as they prevent manipulation of prices by the big players.

Figure 17: Movement of KSE-100



Source: Yahoo Finance and KSE

Year 2004 and 2005 were good for KSE-100 and it notched up 39.1% (ending at 6,218.4 points) and 53.7% (ending at 9,556.6 points) respectively in year 2004 and 2005.

KSE ended year 2006 at 10,040.5 points with modest gains of 5.1%. The reason was that KSE lost about 1,287 points (11.3%) over a period of two months in Nov-06 and Dec-06 in the year 2006.

Till 27Apr -07, KSE-100 registered YTD gain of 21.9%.

Table 37: Top five sectors by Turnover

Sector	Turnover* (Number of Shares mn)
Commercial Banks	46.4
Cement	43.6
Oil & Gas Exploration Companies	15.1
Technology & Communication	10.8
Textile Composite	9.6

Source: KSE

* as at 24 Apr-07

Out of 34 sectors that are actively traded on KSE Commercial Banks and Cement lead by far together making a turnover of 90mn shares on 24 Apr-07. Oil & Gas Exploration Companies, Technology & Communication, Textile Composite are the other top volume grosser.

Table 38: Top 10 Companies by Market Capitalization

Company	Market Capitalization* (US\$ bn)
Oil and Gas Development	8.7
National Bank	3.4
P.T.C.L.A	3.2
MCB Bank	3.0
Pak Petroleum	3.0
United Bank Ltd.	2.5
Nestle Pakistan	1.3
Pak Oilfields	1.1
Pakistan State Oil (P.S.O.)	1.0
Allied Bank Ltd.	0.9

Source: KSE

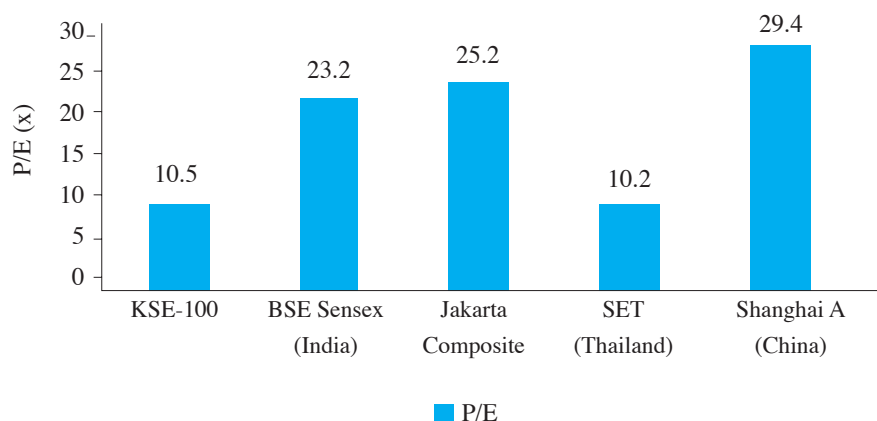
* as at 24 Apr-07

Oil & Gas Development leads the market capitalization list at US\$8.7bn, followed by National Bank and PTC at US\$3.4bn and US\$3.2bn respectively. Out of top 10 companies, four companies belongs to banking and oil & gas sector each.

Comparison of KSE with other markets:

Pakistan appears to be one of the cheapest markets in terms of P/E multiples (10.5X as at Mar-07) reigning at the stock markets in Asian region and other emerging markets (MSCI emerging market P/E of 16X). Only SET (Thailand) is slightly cheaper at 10.2X.

Figure 18: P/E Multiple (Mar-07)

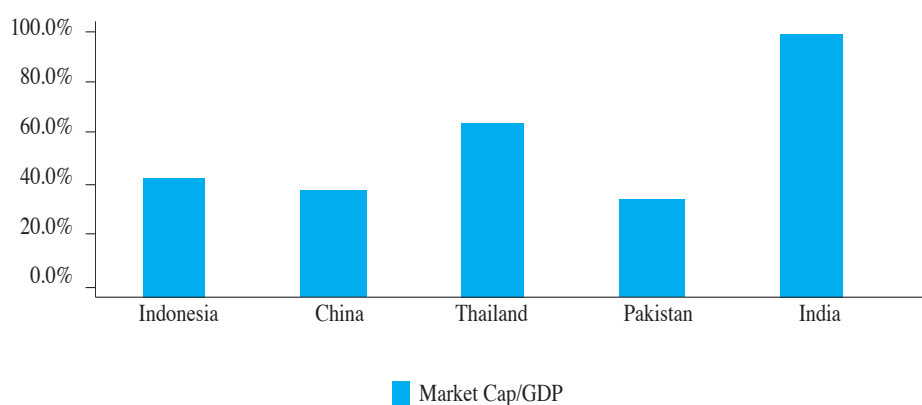


Source: *Global Research & Business Standard*

Considering cheap P/E and high growth in economy, Pakistan's bourses are likely to do well in foreseeable future.

Market capitalization/GDP is considered one of the important indicators of valuation of the stock market of a country. Market capitalization/GDP emphasizes the efficiency, integration and the penetration of the market i.e. the ratio of the companies that is listed on the stock market and the total companies functioning in the country.

Figure 19: Market Cap/GDP (Dec-06)



Source: *Global Research*

Pakistan is one of the cheapest markets in terms of market cap/GDP ratio (about 35%). However, it is in line with other emerging economy except India whose market capitalization/GDP is close to 100%.

Most of the markets in Asian countries have performed well YTD Apr-07.

Table 39: Gain in Indices of Emerging Markets

Indices	Country	Value as at 27 Apr-07	YTD gain (%)
Shanghai Composite	China	3,759.87	40.5
KSE 100	Pakistan	12,235.19	21.9
KLSE Composite	Malaysia	1,324.77	20.9
Straits Times Index	Singapore	3,398.60	13.8
PSE Composite	Philippines	3,318.38	11.3
Jakarta Composite	Indonesia	2,019.68	11.9
Seoul Composite (KOSPI)	South Korea	1,542.52	7.5
Taiwan Weighted Index	Taiwan	7,949.42	1.6
BSE Sensex	India	13,908.58	0.9
SET Index	Thailand	695.11	-4.0

Source: *Global Research*

Pakistan is one of the leading performers at YTD gain of 21.9% second just to China, which has gained 40.5%. Only country to register losses is Thailand, which shows losses of 4% YTD.

Conclusively, Pakistan is a developing market, still in its growing phase as indicated by relatively low Market cap/GDP ratio (about 35%) However, Pakistan is moving in the right direction as shown by strong rules and regulation, increasing market capitalization and listed capital and healthy liquidity in the market.

Bond Market

Government Bond Market

Financial market developments in Pakistan...

The eras of financial market developments in Pakistan can broadly be demarkated into: 1947-1960, 1961-1970, 1971-1990 and 1991 to date periods. The 1947-1960 period witnessed private sector development, however this trend diminished with the emergence of Public Sector Development Institutions in 1961-1970. Public Sector Development Institutions absolutely dominated the arena in 1971-1990 when private sector developments altogether vanished and banking industry came under Government control. Period after the year 1991 saw liberalization stance of the Government and market-based reforms leading to economic recovery in the country and growth of the financial markets.

Growth of the bond market in Pakistan also mirrored the pattern as outlined above. Initial phase lasted up to 1990, when Federal and Provincial governments used to borrow at predetermined rates. The main thrust of the government of Pakistan borrowing was through captive funding, by which the government would hold the fund until a pre-determined period.

Prize Bonds were introduced in 1960 followed by various NSS schemes. These instruments were meant to cover non banking segment. On February-04, Pakistan entered to the international capital markets for the first time since 1999. The government of Pakistan issued US\$500mn five year Regulation Eurobond due in year 2009. The bond issue was lead managed by Deutsche Bank, JP Morgan and ABN Amro Bank. This transaction attracted strong demand from international investors resulting in four times oversubscription. The success of this transaction was an indicator of success of Pakistan's economic policies and reform agenda in convincing the international investors regarding the future of economy of Pakistan.

Objectives of going to international bond markets:

- To make Pakistan visible to the international investors community:

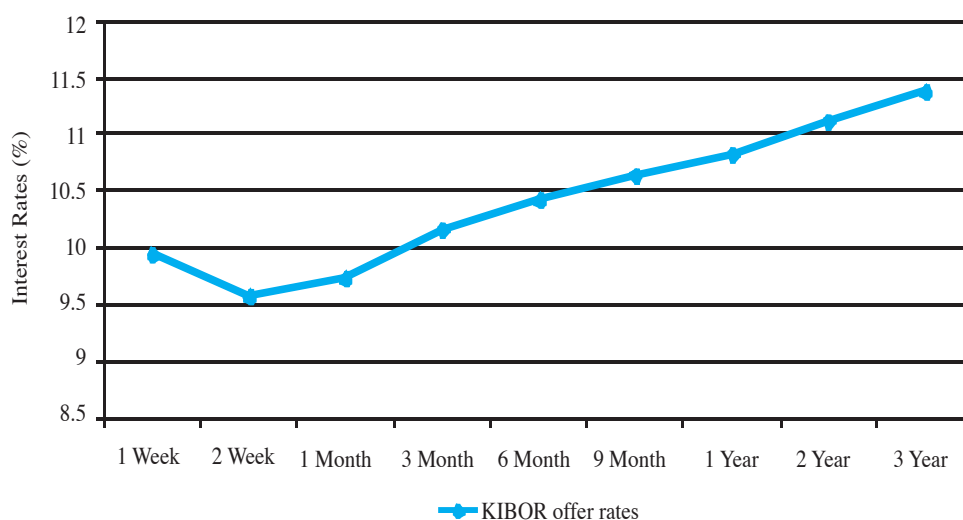
The bond issue would have attracted attention of credit rating agencies, research analysts and international investors to observe Pakistan's economic performance on a permanent basis. This would enable Pakistan to project its success to global investors effectively.

- The bond issue helped Pakistan to be included in emerging market bond index (EMBI):

This would enable the sovereign bonds to be traded in international markets. This again keeps the attention of the international investors to the country's economy and thus attracts foreign investments to it.

- To establish a pricing benchmark:

A benchmark of global bond serves as a reference to the corporate bonds of the country.

Figure 20: Yield Curve

Source: SBP

The yield curve for Pakistan is normal, i.e. going upward, as we move from short to long term. It is in contrast with that seen in US economy where we see a slightly inverted yield curve. The upward sloping yield curve, which is normally expected in an economy means (when considered in conjunction with other indicators) that investors expect the economy to do well in future and investment by the private sector is likely to improve or at least be maintained at the current level.

According to SBP, total size of bond market in Pakistan in 2005 was US\$6.5bn; out of this 82.9% was government securities and rest were corporates' bonds.

As a percentage of GDP it stood at 4.9% of GDP for the government bonds and 1% of GDP for the corporates' bonds. These figures are very low as compared to other international and Asian markets.

Comparison with other markets:

Table 40: Absolute Size of Local Currency Bonds Market and as percentage of GDP (2005)

Country	Government Bonds (% of GDP)	Corporates' Bonds (% of GDP)	Total Size (US\$ bn)
China	22.2	13.0	633.0
Korea	24.8	58.3	637.9
Malaysia	39.1	54.1	121.8
Singapore	40.2	31.3	83.4
Pakistan	4.9	1.0	6.5

Source: SBP

It is evident that bonds market in Pakistan is still in its infancy stage (5.9% of GDP) as compared to countries like Malaysia (93.2% of GDP), Korea (83.1% of GDP) and Singapore (71.5% of GDP).

Table 41: Domestic Debt Position

Figures in US\$ mn

Bond	Stock as on Jun-06	Stock as on Feb-07	Flow during FY07 (Jul-Feb-07)	YTD (Feb-07) Change In Stock (%)
Permanent Debt	8,306.3	8,489.8	183.6	2.2
Federal Government Bond	155.3	153.6	(1.7)	-1.1
Special Government Bond for SLIC (Capitalization)	24.9	9.6	(15.3)	-61.3
Federal Investment Bonds (Auction)	110.4	56.5	(54.0)	-48.9
Federal Investment Bonds (TAP)	0.02	0.02	(0.0)	-0.8
Pakistan Investment Bonds	4,900.7	5,149.1	248.4	5.1
Prize Bonds	2,750.7	2,759.8	9.1	0.3
Floating Debt	15,626.7	17,039.9	1,413.2	9.0
Market T-Bills	7,191.1	8,506.4	1,315.4	18.3
MTBs For Replenishment	8,435.4	8,533.3	97.9	1.2
Unfunded Debt	14,279.3	14,698.2	418.9	2.9
Defence Savings Certificates	4,918.5	4,809.6	(108.9)	-2.2
National Deposit Certificates	0.4	0.4	(0.01)	-2.9
Special Savings Certificates (Reg)	2,324.2	2,351.6	27.4	1.2
Regular Income Certificates	1,157.7	970.7	(187.06)	-16.2
Bahhood Savings Certificates	2,376.4	2,935.3	558.9	23.5
Special Savings Account	865.6	891.8	26.2	3.0
Pensioners' Benefit Accounts	955.6	1,090.0	134.4	14.1
GP Fund	364.8	341.7	(23.1)	-6.3
Total	38,212.2	40,227.9	2,015.7	5.3

Source: SBP

The notable observations in Pakistan bond market on Feb-07 are-

- Permanent debt increased by 2.2% to reach US\$8,489.8mn, Major contributor to this growth was Pakistan Investment Bonds, which increased by 5.1% to reach US\$5,149.1mn. Other category to register growth was Prize Bonds which increased by 0.3% to reach US\$2,759.8mn.
- Floating debt increased by 9.0% to reach US\$17,039.9mn, Market T bills, the main contributor to this growth increased by 18.3% to reach US\$8,506.4mn.
- Unfunded debt increased by 2.9% to reach US\$14,698.2mn, Major contributor to this growth were Bahhood Savings Certificates and Pensioners' Benefit Accounts which increased by 23.5% and 14.1% to reach US\$2,935.3mn and US\$1,090.0mn respectively.
- Total domestic debt increased by 5.3% to reach US\$40,227.9mn.

Outlook for Pakistan bond market is positive and optimistic as economy is doing very well. In addition, secondary market is developing well in Pakistan so is the primary market. Moreover, issue of benchmarking is resolved to a certain extent with successful issuance of sovereign bond in year 2004. In light of this we opine that Pakistan bond market should do well in coming years.

This material was produced by Global Investment House KSCC ('Global'), a firm regulated by the Central Bank of Kuwait. This document is not to be used or considered as an offer to sell or a solicitation of an offer to buy any securities. Global may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities ('securities'), perform services for or solicit business from such issuer, and/or have a position or effect transactions in the securities or options thereof. Global may, to the extent permitted by applicable Kuwaiti law or other applicable laws or regulations, effect transactions in the securities before this material is published to recipients.

Information and opinions contained herein have been compiled or arrived by Global from sources believed to be reliable, but Global has not independently verified the contents of this document. Accordingly, no representation or warranty, express or implied, is made as to and no reliance should be placed on the fairness, accuracy, completeness or correctness of the information and opinions contained in this document. Global accepts no liability for any loss arising from the use of this document or its contents or otherwise arising in connection therewith. This document is not to be relied upon or used in substitution for the exercise of independent judgement. Global shall have no responsibility or liability whatsoever in respect of any inaccuracy in or omission from this or any other document prepared by Global for, or sent by Global to any person and any such person shall be responsible for conducting his own investigation and analysis of the information contained or referred to in this document and of evaluating the merits and risks involved in the securities forming the subject matter of this or other such document.

Opinions and estimates constitute our judgment and are subject to change without prior notice. Past performance is not indicative of future results. This document does not constitute an offer or invitation to subscribe for or purchase any securities, and neither this document nor anything contained herein shall form the basis of any contract or commitment whatsoever. It is being furnished to you solely for your information and may not be reproduced or redistributed to any other person.

Neither this report nor any copy hereof may be distributed in any jurisdiction outside Kuwait where its distribution may be restricted by law. Persons who receive this report should make themselves aware of and adhere to any such restrictions. By accepting this report you agree to be bound by the foregoing limitations.

Global Research

Global Investment House
Tel: (965) 2400551, ext 132 - Fax: (965) 2400661
research@global.com.kw
www.globalinv.net