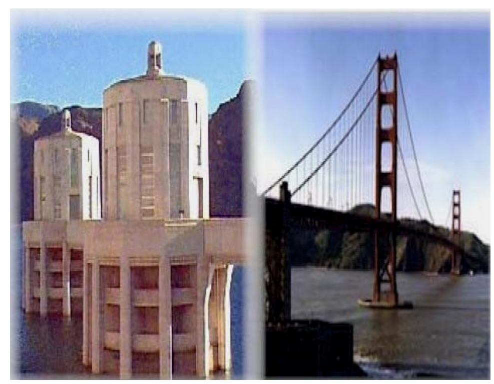

Development Finance Quarterly Review

As of June 30,2012

Development Finance Group

State Bank of Pakistan

Team Leader

Muhammad Ashraf Khan ashraf.khan@sbp.org.pk

Members

Reviewed by:

Syed Samar Hasnain samar.husnain@sbp.org.pk

Dr. Saeed Ahmed dr.ahmed@sbp.org.pk

Mr. Imran Ahmad Imran.ahmad@sbp.org.pk

Prepared by:

Mr. Karim Alam karim.alam@sbp.org.pk

Contributors

- Mr. Muhammad Ishfaq (Team Leader- Refinance Schemes), Syed Muhammad Hafeez, Mr. Usman Shaukat
- Mr. Allauddin Achakzai (Team leader-SME Finance), Mr. Saeed Afgan
- Mr. Qazi Shoaib Ahmad (Team Leader-Microfinance), Mr. Sharoon Rasheed
- Mr. Muhammad Imaduddin (Team Leader-Agri. Finance), Syed Ali Raza
- Mr. Wasif Hussain

For feedback/queries: ihfd.reporting@sbp.org.pk

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Executive Summary

Economy of the country is still in the phase of recession with challenges like energy crisis, decline in investment, and poor law & order. Besides, government's difficult financial position and dwindling FDI remained critical areas of distress for the economy. In such an economic scenario, the priority sectors financing (PSF) was not an exception which is evident from the decline in outstanding amount by 3.4 percent on YoY basis. However, QoQ basis, a rise of 1.9 percent was recorded (See Table 1 for QoQ and YoY changes).

Table 1: Sectoral Break up of Outstanding Advances (Billions)

Sectors	Periods			Change	
	Jun-11	**Mar-12**	**Jun-12**	**Q.C**	**Y.C**
SME Finance	292.5	259.4	247.9	-4.4%	-15.3%
Agriculture	169.2	176.3	189.9	7.7%	12.2%
Microfinance (MFBs Only)	13.5	16.8	17.2	2.3%	27.4%
Housing Finance	61.6	58.6	57.7	-1.5%	-6.3%
Infrastructure Finance	290.0	273.0	286.3	4.9%	-1.3%
Total	826.9	784.2	799.0	1.9%	-3.4%

Pakistan's economy continued facing challenges during the quarter too

At the end of Jun-12, when compared with the preceding quarter, there was a rise of 1.9 percent cumulative Development Finance (DF) portfolio was primarily driven by agricultural and infrastructure sectors. However, YoY basis, the DF portfolio witnessed a decline of 3.4 percent was due to SME sector. Further, while SME and housing finances continued to decline, agricultural credit and microfinance recorded positive growth on QoQ and YoY basis. In addition to the factors stated earlier, the decline in aggregate DF is owed to both demand and supply factors. On the supply side, banks' risk appetite remained subdued, particularly given the opportunity offered by aggressive government sector borrowings. Similarly, the demand was constrained by the unfavorable economic conditions.

Agriculture and microcredit posted growth both QoQ and YoY basis

Interestingly, the combined number of DF outstanding borrowers saw a growth of 3.5 percent on QoQ basis primarily led by agri. sector (11.6 percent i.e. inclusion of 0.5 million micro borrowers). Furthermore, all other DF sectors witnessed decline in their number of outstanding borrowers. Moreover, on YoY basis, the number of outstanding DF borrowers rose by 1.7 percent mostly attributed to agri and microfinance sectors. The rise in microfinance borrowers can be attributed to the use of alternative delivery channels and in particular the branchless banking.

Agri and microfinance borrowers witnessed growth at the end of the quarter under review

Statistics regarding aggregate non-performing loans (NPLs) of the Banks & DFIs depict a rise of 2.2 percent on QoQ basis, primarily driven by the agriculture and infrastructure sectors. Moreover, on YoY basis, the rise in DF NPLs was recorded at 3.6 percent mainly attributed to infrastructure project financing. However, the NPLs of agri. sector saw a decline of 1.6 percent on YoY basis. Of the total NPLs of DF Sectors, SME's share was 57.3 percent, agri. sector 20.6 percent, and the remaining 22.2 percent pertained to the remaining DF sectors.

NPLs of DF sectors saw some increase primarily due to Infrastructure and Agri. sectors

1.0. SME Financing

The declining trend in SME financing by banks/DFIs, which started in 2008, continued through this quarter too. This consistent decline in SME financing has also reduced the share of SMEs in overall advances of banks from 16 percent to less than 7 percent in the last 4-5 years. The decreasing SME financing can be attributed to adverse economic conditions, law and order situation, shortages and rising costs of electricity and other utilities, and growing NPLs. The floods in Sindh and Punjab in two consecutive years of 2010 and 2011 practically annihilated small sized units which had little financial resources to rebuild and revitalize their businesses. Given the deteriorating business conditions for SMEs, the banks also took a more risk-averse posture and diverted significant funds to less risky asset classes such as Market T-bills and commodity operations of the government which further squeezed the available funds and aggravated the prevalent conditions for SMEs.

SMEs have been hit hardly by the prevailing economic conditions.

Table 1: SME Financing Profile

Category	Periods			Change	
(Amount in Rs. Billions)	Jun-11	Mar-12	Jun-12	QoQ	YoY
Total SME Exposure	292.5	259.4	247.9	-4.5%	-15.3%
SME exposure as % of total advances	8.2%	7.1%	6.6%		
NPLs: absolute amount (Rs. Billions)	96.2	99.2	96.4	-2.7%	0.2%
NPLs as % of total SME exposure	32.9%	38.2%	38.9%		
No. of SME Borrowers	194,110	157,115	147,578	-6.1%	-24.0%

The share of SMEs in total industry advances reduced to 6.6 percent.

At the end of quarter under review, total SME advances declined by 4.5 percent, QoQ basis. However, the decline was more than 15 percent when compared YoY basis. The number of SME borrowers, however, declined by around 24 percent on YoY basis, which indicates towards our assertion that small enterprises were worse hit by the prevailing macroeconomic conditions. Although the absolute amount of SME NPLs decreased by more than Rs. 2.7 billion from the previous quarter, this decline is offset by faster decline in SME advances and resultantly NPLs as a proportion of SME advances have increased when compared with the previous quarter. It is worth mentioning here that the overall non-performing loans of the

NPLs under SME Financing saw a decline of 2.7 percent.

industry have remained stagnant over the last few quarters (with negligible increase on QoQ and YoY basis).

Trading SMEs have the lion's share in total SME outstanding

A breakup of enterprise-wise position shows that the biggest share of 46.5 percent was taken by the trading SMEs, followed by manufacturing SMEs with 35.9 percent, and services SMEs with 17.6 percent. The working capital financing constitutes more than 77 percent of SME financing followed by trade finance and fixed investment with their shares of 11.8 percent and 11.1 percent respectively. Further, most of the banks' financing (around 98%) was collateralized while only 2 percent of total SME advances was clean (without security).

Bank's risk averseness is resulting in reduced financing for BMR and new business projects.

The predominantly higher percentage of working capital financing and collateralized financing reflects the approach of banks to invest in relatively secure avenues and avoid taking risk on economic performance of small business units in longer periods. This approach is resulting in reduced availability of financing for BMR and new business projects as reflected in relatively small share of fixed investment SME financing.

Bank-wise distribution of SME lending shows that the share of *Private Sector Banks (17 institutions)* in total SME loans outstanding is highest at 81.7 percent and their share has increased by around 2 percent points from their share in the previous quarter. *Private sector banks* are followed by *public sector banks* (NBP, FWBL, BOP, BOK, and Sindh Bank) which share around 14 percent of the total SME outstanding amount.

Islamic Financing to SME sector saw a rise of about 4 percent QoQ basis.

A review of Islamic Banking Industry (including Islamic Banks and Islamic Banking Divisions of Commercial Banks) shows that the exposure of Islamic financing for SMEs stood at Rs. 10.85 billion at the end of Jun-12, recording an increase of more than 4 percent, QoQ basis. Following the overall trend, the SME exposure of Islamic banks' witnessed a decline of about 3.7 percent, from Rs. 4.33 billion in Mar-12 to Rs. 4.16 billion in Jun-12. The Share of Islamic Banking Divisions in total SME financing, however, witnessed an increase of more than 9 percent which was significant enough to increase the Islamic financing of banks towards SMEs. The share of Islamic Banking Divisions of conventional banks in total SME outstanding stood at percent 2.7 percent (Rs. 6.68 Billion) at the end of the period under review.

2.0. Microfinance

Table 2: Snapshot of Micro Financing

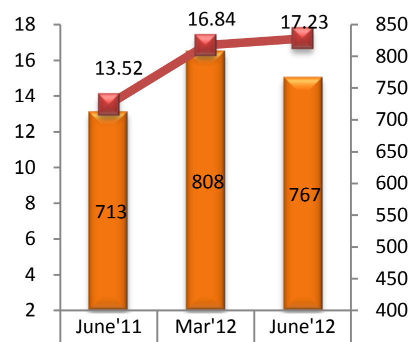
Outreach	Jun-11	Mar-12	Jun-12	Change	
***(Amount in Rs. '000')**				**QoQ**	**YoY**
Borrowers	713,563	807,986	767,904	-5%	8%
Advances *	13,523,748	16,837,011	17,235,491	2%	27%
NPLs*	505,431	626,165	750,082	20%	48%
PAR >30 Days in %	3.74%	3.72%	4.30%	16%	15%
Deposits*	11,167,174	13,634,625	16,609,330	22%	49%
Assets*	26,471,237	30,443,035	34,622,345	14%	31%
Equity*	6,364,125	6,951,699	8,202,272	18%	29%
Avg. Loan Size	18,952	20,838	22,520	8%	19%

Microfinance banking sector of Pakistan has witnessed the stagnation in the credit growth during the 2nd quarter of 2012 due to seasonal factors. *Outstanding advances* of MFBs reached Rs. 17.2 billion after a modest growth of 3 percent whereas number of borrowers reduced to 767,904 after a decline by 5 percent during the current quarter. On positive side, sector experienced uptake in deposits, assets and equity base by 22 percent, 14 percent & 18 percent respectively.

The increase in microcredit during the quarter is attributed to fresh credit disbursement to agriculture sector.

A significant reason cited by banks for the slowdown of growth in advances and number of borrowers was the reduction in disbursement for agri-inputs by 11 percent. Since the largest proportion of industry's credit portfolio is directed towards agriculture, the lower demand for agricultural input generally led to lower disbursement in this quarter. This pattern thus signifies the need for gradual shift in the composition of advances to other sectors. In order to mature as an industry capable of reaching millions of unbanked people in Pakistan, the sector must come up with diversified clients-responsive products. Analysis of data shows that a*griculture financing* (agri inputs & livestock) constituted 48 percent of the total outstanding advances of the sector compared to 53 percent during the previous quarter. Analysis also shows that 35 percent of loan portfolio of industry is secured, primarily due to gold backed lending of Tameer MFB. Tameer MFB leads the industry in terms of value of advances with Rs. 6.2 billion followed by KBL (Rs. 4.5 billion). Encouragingly, the disbursment to microenterprises

Fig 2a: Advances & Borrowers

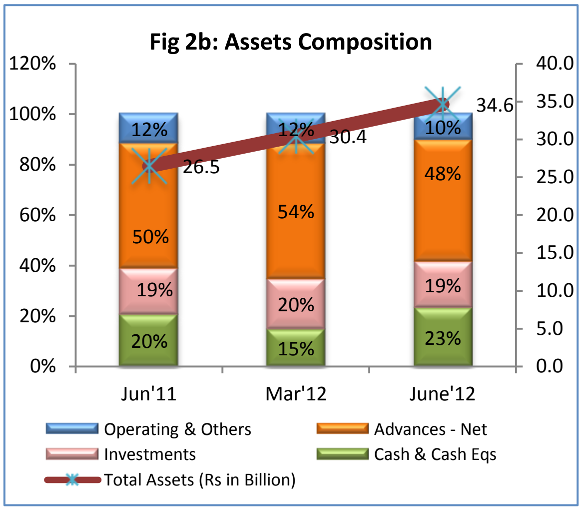


	June'11	Mar'12	June'12
Borrowers (in '000')	713	808	767
Advances (Rs. in billion)	13.52	16.84	17.23
PAR >30 days	3.74%	3.70%	4.30%

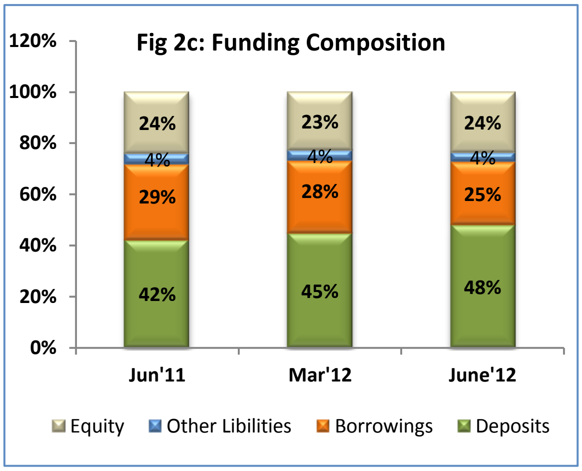
reached Rs. 2.59 billion after an increase of 15 percent during the qarter. Moreover, consistent improvement in *average outstanding loan size* of MFBs was witnessed; currently standing at *Rs. 22,520*.

Non Performing Loans (NPLs) increased from 3.7 percent to 4.3 percent during the current quarter. There was significant rise in loss category as MFBs had to unfreeze the provision against rescheduled loans in flood affected areas after the regulatory relaxation on provision expired on Dec-11.

Overall, a positive trend was witnessed in the overall asset base of MFBs. Moreover, MFBs liquidity position remained quite comfortable as liquid assets (cash & investments) constitute 42 percent of total assets. The asset base of MFBs rose to *Rs. 34 billion*. Advances constituted 48 percent compared to 54 percent during the last quarter, whereas cash and cash equivalent constituted 23 percent of the overall asset composition. Advances and investment components have shown a decline whereas the cash category has increased sharply by 78 percent owing to rise in deposits, loan recoveries and equity injections. The trend also showed that banks were holding excess cash for onward lending to agriculture sector in the upcoming Rabi season. This calls for better liquidity management practices by MFBs i.e. holding excess reserves may have an opportunity cost if higher interest can be earned by investing the funds elsewhere.



On the funding side, a positive change was observed in the deposits which now constitute 48 percent of the total funding composition. Deposit-Debt mix changed from 45-28 percent to 48-25 percent in this quarter (see figure 2c). The main players for increase in deposits were KBL (92% rise), NRSP MFB (45% rise) and KASHF MFB (35% rise). The staggering growth in the deposits for KBL was primarily due to increase of its saving accounts (198%) and current accounts (70%). On equity side, a positive change (18%) was observed due to the inclusion of Waseela MFB in the realm of Microfinance banking. These growing trends in deposits and equity signify that micro-banking industry is gradually heading towards sustainable sources of funding instead of relying on subsidies and/or grants. At the moment, four MFBs i.e. KBL, Tameer, Waseela and NRSP have their paid-up capital equal to or exceeding Rs. 1 billion.



The trend in advances and number of borrowers is likely to improve in upcoming quarter because of fresh lending to agriculture sector for Rabi season. In coming quarters, contribution of equity is also likely to increase in view of expected injection by few MFBs to meet revised minimum capital requirement (MCR).

3.0. Agricultural Finance

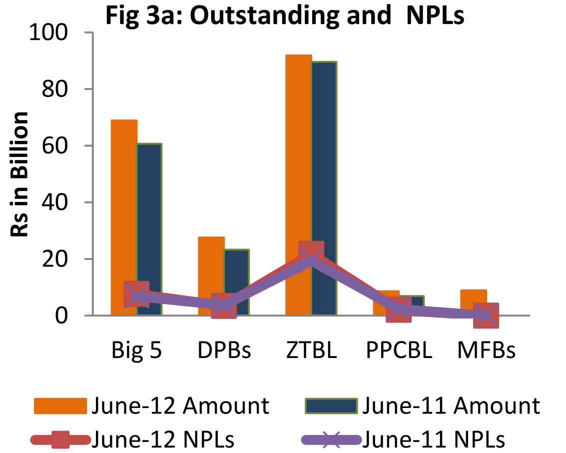
Under indicative agri. Credit, disbursement target of about Rs.12.2 billion was allocated to microfinance banks for FY 11-12

Table: 3 Agriculture Finance (Amount in Billions)

Category	FY 10-11	FY 11-12	Change (YoY)
Amount Disbursed	263.0	293.8	11.7%
Amount Outstanding	193.3	221.5	14.6%
NPLs	32.3	35.1	8.7%
Outstanding Borrowers	1,790,372	2,267,867	26.7%
Data compiled on monthly basis by AC&MFD and also MFBs included since July, 2011			

Banks surpassed **agri. credit disbursement** target for the year 2011-12 set by the Agricultural Credit Advisory Committee (ACAC). Against the indicative target of Rs. 285 billion for the year ending Jun-12, banks disbursed Rs. 293.8 billion, which is 11.7 percent higher than Rs. 263.0 billion disbursed in 2010-11. Achievement of the target was extremely difficult in the backdrop of continuous declining trend in the overall private sector credit and high agri. NPLs of major banks due to devastating floods of 2010 and then heavy rains of 2011 in Sindh province. However, SBP adopted a multipronged strategy and made all out efforts in achieving the target which included swift settlement of crop loan insurance claims, close co-ordination with provincial revenue departments to facilitate the One Window Operation in agri. intensive districts for timely completion of revenue formalities, holding of farmers' awareness and financial literacy programs at grass root level, and follow up of indicative targets with the top management of banks and their agri. heads. The contribution by SBP BSC field offices in monitoring the regional targets was also significantly helpful.

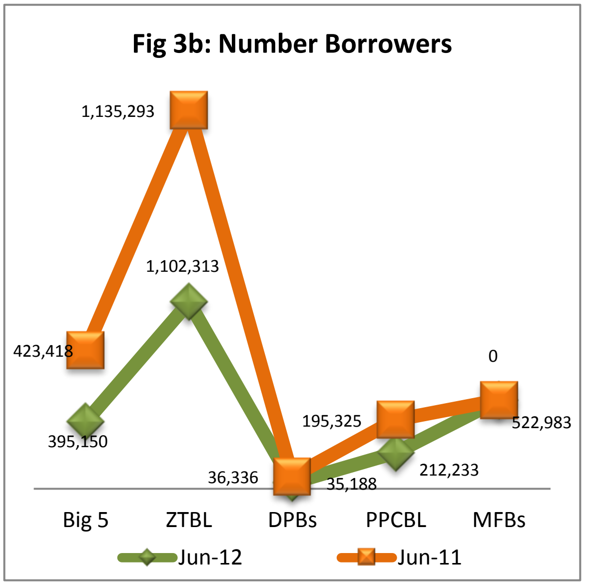
Fig 3a: Outstanding and NPLs



Non-performing loans in agri. financing stood at Rs. 35.1 billion or 17 percent of the outstanding loans as on Jun-12 compared with

Rs. 32.3 billion or 17.9 percent of the outstanding loans as on Jun-11. Swift settlement of Crop Loan Insurance claims of banks and prudent lending practices may be ascribed for this declining trend.

Outstanding loans by banks during the period amounted to Rs. 221.5 billion compared with Rs. 193.3 billion in the corresponding period last year, showing an increase of 14.6 percent. Figure 3a shows outstanding agri. loans and NPLs' position of banks during July-June, 2011-12 and 2010-11.



The number of agri. loan borrowers was around 2.3 million as on Jun-12 as against 1.79 million as on Jun-11, showing an increase of 26.7 percent YoY mainly due to inclusion of 0.5 million borrowers of MFBs which have been included in agricultural financing from this year. This shows decline in number of agri. borrowers of commercial & specialized banks to 1.74 million as on 30th June 2012 from 1.79 million at end June 2011. The bank-wise position of outstanding number of borrowers is shown in Figure 3b.

Sector-wise classification reveals that during July-June, 2011-12, out of disbursement of Rs. 293.8 billion, an amount of Rs. 196.2 billion or 66.8 percent was disbursed to farm sector and Rs. 97.6 billion or 33.2 percent were disbursed to non-farm sector as compared with disbursement of Rs. 178.7 billion or 67.9 percent and Rs. 84.3 billion or 32.1 percent respectively during the corresponding period last year. In the farm sub-sectors, a major chunk (96.5%) of credit was disbursed as production loans while the share of development loans remained stagnant at 3.5 percent of the total credit to farm sectors. Overall position indicates that disbursement to non-farm sector has continued its rising trend. This is mainly due to continual disbursement in livestock by banks due to their huge potential and prospective returns.

Disbursements to non farm sector continued its rising trend attributable to the prospective returns and potential.

4.0. Housing Finance

Table 4: Housing Finance - Amount (Rs. Billions)						
	June-12		Mar-12		% Change (Amount)	
	Borrowers	Amount	Borrowers	Amount	QoQ	YoY
Cumulative Disbursement	502,184	181.35	501,270	178.63	0.2%	6%
Outstanding	34,049	38.66	34,287	38.42	-0.7%	-11%
NPLs	53,147	19.07	54,974	20.13	-3.3%	2%
Gross Outstanding	87,196	57.74	89,261	58.55	-2.3%	-7%

HBFCL, the only institution catering to the lower-middle and low-income groups, enjoys the largest customer base.

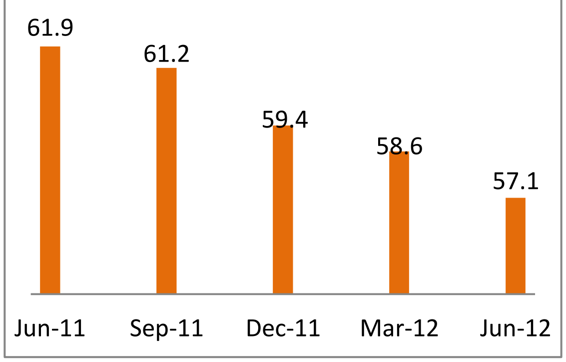
Gross Outstanding

Total outstanding finance as on Jun-12 of all banks and DFIs stood at Rs. 57.1 billion, as compared to Rs. 58.6 billion as on Mar-12, showing a decrease of Rs. 0.9 billion (1.53 percent).

Of the total outstanding as on Jun-12, commercial banks accounted for Rs. 44.6 billion. Private banks reported Rs. 27.9 billion followed by Islamic banks at Rs. 8.8 billion, public sector banks at Rs. 7.6 billion and foreign banks with Rs. 0.3 billion. The outstanding loans of HBFCL were Rs. 12.9 billion; down by five percent over the last year. Other DFIs had outstanding loans of Rs. 0.2 billion.

The total outstanding housing finance as on Jun-12 of Islamic Banking Industry (05 Islamic Banks-IBs & 12 Islamic Banking branches-IBBs of Conventional Banks) stood at Rs. 12.7 billion. Of the total outstanding Islamic housing finance, Islamic banks accounted for Rs. 8.8 billion. IBDs of conventional banks posted Rs. 3.8 billion.

Fig 4a: Industry Gross Outstanding



Outstanding of Islamic Banking Industry stood at Rs. 12.7 billion at the end of quarter Apr-June 2012.

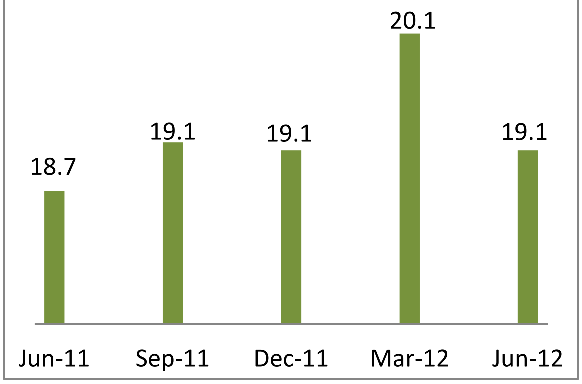
Non-Performing Loans (NPLs)

NPLs decreased from Rs. 20.1 billion (Mar-12) to Rs. 19.1 billion (Jun-12); down by 5.2 percent during the quarter.

HBFCL's NPLs increased from Rs. 6.9 billion to Rs. 7.7 billion during the quarter; up by 11.7 percent. Although growth of its NPLs remained relatively low in absolute terms when compared to some of the other banking sectors, its percentage share in its total outstanding, however, is the largest, as 61 percent of its total outstanding constitutes NPLs. HBFCL's percentage share in total NPLs is 41 percent. The percentage share of NPLs of all banks and other DFIs (excluding HBFCL) was 59 percent in total NPLs, compared to a 63 percent as of Jun-11.

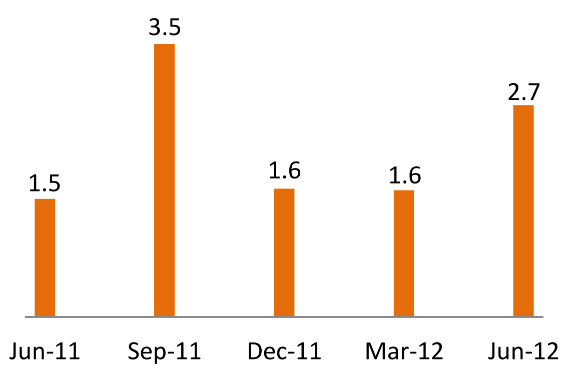
Non-Performing Finances (NPFs) of Islamic Banking Industry (IBs &

Fig 4b: Industry NPLs



IBDs) were reported as Rs. 1.2 billion on Jun-12, which were Rs. 2.2 billion at the end of last quarter (Jan-Mar, 2012) showing a decrease of 36 percent.

Fig 4c: Industry Qtr Disbursement



Disbursements

Fresh disbursements to the tune of Rs. 2.7 billion (Figure 4c) were made to 811 borrowers during the quarter under review. *Private Sector banks* extended new disbursements with Rs. 1.5 billion followed by *Islamic banks* with Rs. 689 million, *Public Sector banks* with Rs. 25 million and foreign banks with Rs. 4 million. HBFCL's fresh disbursement for the quarter was reported to be Rs. 408 million. Among commercial banks, the number of new borrowers totaled 300, with private banks serving 133 borrowers and Islamic banks 155 customers. HBFCL extended loans to 511 new borrowers during the reporting quarter.

Fresh disbursement for Islamic Banking Industry was Rs. 1 billion to 209 new borrowers during the quarter ending June 30, 2012. This includes new disbursements of Rs. 317.5 million to 54 customers by IBBs of conventional banks.

Outstanding amount of MFBs decreased by 4 percent over the quarter & increased by more than 100 percent when compared to the yester quarter.

Housing Finance Business of Microfinance Banks

The total outstanding housing finance of Micro Finance Banks (MFBs) was Rs. 168.2 millions as on Jun-12 which was Rs. 174.5 millions at the end of Mar-11. It registered a decrease of 4 percent over the last quarter. **NPLs** for MFBs increased from Rs. 1.7 million (Mar-12) to Rs. 3.9 million (Jun-12); showing an increase of 121 percent over the last quarter. NPLs of MFBs arising out of housing finance business are around 2 percent of their outstanding housing finance portfolio. Number of outstanding borrowers increased from 2,297 to 2,783 since Jun-11; up by 21 percent.

Box 1: Housing Finance Review 2005-11

- SBP has published Housing Finance Review 2005-2011, showing different trends and analysis concerning housing finance.
- Review covers the analysis of government policies and presents trends on disbursements, outstanding, non performing loans (NPLs) and other components of housing finance from year 2005 to 2011.
- The document can be accessed through the following link http://www.sbp.org.pk/sme/PDF/HF-Review-2005-2011.pdf

5.0. Infrastructure Finance

Cumulative disbursements to Infrastructure sectors saw a rise of 7.8 percent, YoY basis.

Table 5: Infrastructure Project Financing Profile					
(Amount in Billions)	Periods			% Change	
	Jun-11	Mar-12	Jun-12	QoQ	YoY
Amount Outstanding	290.8	273.2	286.3	4.8%	-1.6%
NPLs	8.2	13.3	17.5	31.5%	112.6%
Disbursements (Cumulative)	318.8	342.7	343.5	0.2%	7.8%
No. of Projects (*Cumulative)	300	325	348	7.1%	16.0%
Total Sanctioned Amount	557.3	541.1	480.8	-11.1%	-13.7%
*Cumulative number of projects is the total number of projects less the matured ones.					

Quality Infrastructure affects economic growth potential of a country.

It is pertinent to reiterate that quality infrastructure affects economic growth potential of a country as well as the ability of an enterprise to engage effectively. Infrastructure investment and consumption of infrastructure services have significant implications for achievement of sustainable development objectives, as infrastructure services encourage new investment and underpin many aspects of economic and social activity.

Infrastructure Financing saw a rise of 4.8 percent when compared with the preceding quarter.

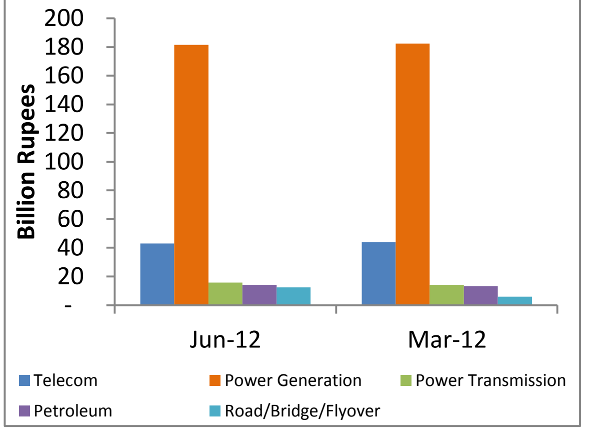
At the end of Jun-12, the amount outstanding against infrastructure project finance saw a rise of 4.8 percent, QoQ basis. While, a sector wise analysis reveals that the lion's share (63 percent) in total Infrastructure financing went to Power Generation sector, followed by Telecom sector with 16.4 percent and 8.9 percent by power transmission.

NPLs have increased considerably from Rs. 13.3 billion to Rs. 17.5 billion, recording a rise of over 30 percent, QoQ basis. However, keeping in view the nature of project financing, their implication is almost insignificant.

Outstanding Portfolio

Total financing outstanding at the end of Jun-12 rose to Rs. 290.8 billion when compared with Rs. 273.2 billion at the end Mar-12. A segregate review showed that Power Generation sector stood out among all the sectors of infrastructure despite a minor decrease of 0.5 percent when compared with preceding quarter. A number of factors like power policy, availability of sovereign guarantees in case of IPPs, and expertise of financial sector in this area

Fig 5a: Outstanding - Top 5 Sectors



contributed to its consistent lead over other sectors. Moreover, Petroleum and Power Transmission sectors have also shown an upward trend of 7.0 and 11.7 percent respectively, while Oil & Gas sector saw a decline of 10.7 percent, QoQ basis. At the end of the quarter under review, interestingly, LPG Exploration & Distribution, and Road/Bridge/Flyover sectors saw a rise of more than 100 percent each.

Banking-sector wise Share

At the end of Jun-12, following the usual trend, private sector banks' share remained the highest in the total outstanding amount with 73 percent followed by public banks with 19 percent and 5 percent by DFIs, whereas the share of foreign and Islamic banks remained less than 2 percent each. Similar trends were observed in total amount disbursed during the quarter, amount sanctioned, and cumulative disbursements as well.

Currently, two Islamic banks are doing Islamic project financing and their combined share was about 1.3 percent (Rs. 3.7 billion) in total outstanding to Infrastructure sectors.

Disbursements

During the quarter under review, an amount of Rs. 10.3 billion was disbursed in all infrastructure sectors against Rs. 10.4 billion in the preceding quarter, a decline of 0.9 percent QoQ basis. However, there was a rise of more than 50 percent when compared YoY basis. Moreover, the cumulative disbursements at the end of Jun-12 saw a rise of 0.2 percent, QoQ basis. However, on YoY basis, a rise of 7.8 percent was recorded mainly driven by Power Generation, Petroleum and Telecom sectors.

New Projects during the Quarter

During the quarter under review, a total of 9 new projects were undertaken by banks & DFIs, of which 5 were in Power generation sector, 2 in Telecom and one each in the categories of Oil & Gas exploration/distribution, and Roads/Brides/Flyovers. For these new projects, an amount of about Rs. 110.9 billion has been sanctioned by the banks & DFIs.

Box 2: Task Force on Urban Development

- Planning Commission, Government of Pakistan had established a **Task Force on Urban Development** in June, 2010 to review the prevailing urban conditions and establish principles that provide sound underpinnings for a consensus national urban policy.
- The subject report can be accessed at http://www.pc.gov.pk/

Box 3: Infrastructure Project Finance Guidelines

- SBP's Infrastructure Project Finance Guidelines can be accessed at http://www.sbp.org.pk/ihfd/2010/Annex-CL1.pdf

About Rs. 111 billion have been sanctioned by Banks/DFIs for 9 new infrastructure projects.

6.0. SBP Refinance Schemes

Table 6: Outstanding Financing Under SBP Refinance Schemes

	Periods			% Change	
	Jun-11	**Mar-12**	**Jun-12**	**YoY**	**QoQ**
Export Finance Scheme	190.5	178.5	164.8	-13.5%	-7.7%
Long Term Financing Facilities	26.6	31.6	32.7	23.0%	3.7%
Defunct LTF-EOP	16.2	11.1	9.6	-40.4%	-13.0%
Scheme for Modernization of SMEs	0.2	0.2	0.1	-8.3%	-6.5%
Scheme for Storage of Agri. Produce (FFSAP)	1.1	1.7	1.9	73.0%	17.1%
Scheme for Flood Affected Areas	0.3	2.9	1.9	467.7%	-35.9%
Total	**234.9**	**226.0**	**211.2**	**-10.1%**	**-6.6%**

SBP continued financing to exporters through banks under its refinance facilities and took measures to facilitate exporters to improve exports of the country. In line with decision of reducing its policy rate by 150 basis points, rates under Export Finance Scheme (EFS) and Long Term Financing facilities were also reduced to keep the cost of doing business competitive for the exporters. Resultantly, the mark up rate under EFS has been reduced to 9.5 percent from 11 percent. Under Long Term Financing Facility (LTFF) rates have been reduced to 11.0 percent, 11.10 percent to 11.20 percent for 3, 5 and 10 years tenors respectively. Similarly rates under Scheme for Financing Power Plants Using Renewable Energy Scheme have been reduced to 11.10 percent and 11.2 percent for 5 and 10 years tenors respectively.

Mark up rates under EFS and LTFF reduced by 150 basis points.

To further facilitate the exporters, in the face of heavy shortage of power which made difficult for exporters to meet export targets, SBP provided two months relaxation in export performance period under EFS part-II for the monitoring year 2011-12. Exporters who availed the benefit of extension in performance period were not allowed to avail benefit of performance based rebate of mark up under EFS Part -II for the year FY 2011-12.

SBP provided two months relaxation in export performance to further facilitate the exporters

Appropriate adjustments were made in the limits sanctioned to banks under EFS to avoid problems of exporters, whereas the overall limit stood at existing level of Rs. 255.08 billion. The outstanding position under EFS stood at Rs. 165 billion showing a decrease of about 8 percent together with a 10.4 percent decrease in number of borrowers on QoQ basis. This decrease may be mainly attributable to SBP's

The overall limit under EFS stood at Rs. 255.1 billion decision of linking EFS facility with the overdue proceeds and narrowing gap between EFS rate and market mark up rates.

Sector-wise Financing under EFS and long term financing facilities

The textile sector continues to be the major beneficiary of SBP refinancing facilities

The commodity-wise EFS outstanding financing of Rs. 164.8 billion shows textile sector at the top with Rs. 100.3 billion (60.9%) followed by edible goods with Rs. 25.6 billion (15.5%). Similarly under LTFF, textile sector is the largest beneficiary of the SBP refinance facility. As of Jun-12, total refinance outstanding, under long term facilities extended by SBP, was Rs. 42.4 billion. Since prime focus of SBP remained on promotion of exports through long term investment, share of LTFF in total outstanding was 91.4 percent. The remaining 8.6 percent financing was made for the development of agricultural produce storage facilities and long term investment in Small and Medium Enterprises (SMEs).

Borrower-wise Distribution of EFS Funds

There was a decline in the number of borrowers-reason might be exclusion of those borrowers who have export overdue proceeds beyond the benchmark for availing EFS financing

At the end of Jun-12, the total number of borrowers under Export Finance Scheme (EFS) stood at 1,273 with an average loan size of Rs. 128 million. This quarter saw a decrease of 10.4 percent in total number of borrowers as compared to previous quarter. The data trend reinforces that the SBP's decision of linking EFS facility with the overdue proceeds is believed to be the reason behind the drop in number of borrowers which allows EFS facility to only those borrowers whose total amount of overdue export bills at the time of availing the facility is not more than 5 percent of the previous year's export performance.

Islamic Export Refinance Scheme

Of the total sanctioned under EFS, the limits assigned for IERS were increased by 13 percent (to Rs. 41 billion from Rs 36.2 billion in Mar-12), out of which Rs. 14.8 billion limit was allocated to IBs and remaining Rs. 26.2 billion to IBBs. The limit utilization under IERS for IBs was 60 percent while for IBBs was 18 percent. The total IERS financing outstanding at the end of the quarter stood at Rs. 13.6 billion, declined by 19 percent from previous quarter's outstanding of Rs. 16.78 billion. During the quarter under review, total number of participating banks was 12 (5 Islamic Banks (IBs), 7 Conventional Banks' Islamic Banking Operations (IBBs)).

The total outstanding financing under IERS stood at Rs.13.6 billion and saw a decline of 19 percent QoQ basis.

7.0. Key Development Finance Initiatives – Policy and Industry

Appreciating the critical role and significance of Development Finance for the sustainable economic growth in the country, SBP took the following key measures during the quarter Dec-Mar, 2012.

SBP allows financing to dairy sector under LTFF

Under Cir Letter No. 04 of March 16, 2012, banks/DFIs can also provide financing facilities for new imported and locally manufactured plant, machinery & equipment to be used by the export oriented projects for storage, chilling, processing and packaging of dairy products including machinery used in the conversion/preservation of milk into powdered form, keeping in view the terms and conditions of the subject facility.

SBP prescribes standard application format for refund of fine under EFS

With a view to bring more clarity and simplify the procedure of submission of refund of fine cases, SBP prescribed a Standard Application Format for Refund of Fine under the Export Finance Scheme vide IH&SMEFD Circular Letter No. 5 of June 06, 2012. This will not only save time required for examining refund cases but also reduce load of documents being submitted by banks to State Bank of Pakistan.

SBP extends validity period of scheme for financing power plants using renewable energy

SBP vide IH&SMEFD Circular Letter No.6 of June 06, 2012, has extended the validity period of Scheme for Financing Power Plants Using Renewable Energy for a further period of two years i.e. up to 30th June, 2014. Its validity was due to expire on 30th June, 2012. Now the financing facilities under this Scheme will be available for Letter of Credits (LCs) established for import/purchase of new plant, machinery & equipment up-to June 30, 2014.

Payment of Claims of 2nd Installment of Export Finance Mark-Up Rate Facility

On budgetary allocation for FY 2011-12 by Ministry of Textile Industry, SBP announced to release Export Finance Mark up Rate Facility to the extent of 23% of total claims against the cases, which have been found in order and where 55% reimbursement has already been made to the banks under said Scheme. Banks were advised to pass this additional reimbursement to the concerned exporters immediately as the budgetary allocations for 2011-12 will expire on 30-06-2012.

SBP allows additional two months to exporters for matching performance requirement

SBP allowed an additional two months for the exporters having shortfall in required performance under Part-II of the Export Finance Scheme for the monitoring year of 2011-12. This decision has been taken to address exporters' problems of delay in meeting the export orders due to heavy shortage of power. This relaxation is only for the purpose of allowing extended period (i.e. till August 31, 2012) for matching performance requirement and exporters who will avail this facility would not be entitled to avail benefit of incentives-based rebate of mark up.

Meetings of Sub-Groups of National Consultative Group for Branchless Banking

A meeting of a Sub-Group on Code of Conduct for branchless banking was held on June 29, 2012 at State Bank of Pakistan under the chairmanship of Mr. Mansoor Hassan Siddiqui, Director, Banking Policy and Regulations Department (BPRD). Another meeting of a Sub-Group on Agents Development was also held on July 5, 2012 at State Bank of Pakistan. Dr. Saeed Ahmed, Head, Agricultural Credit and Microfinance Department (AC&MFD)

chaired the meeting and highlighted 'agents' as the most crucial access points to advance financial inclusion in the country. He stressed the need for determining an 'optimal size' of BB agents in the country to understand the dynamics of future market development in branchless banking. The participants had a substantive discussion and finalized their initial recommendations.

Microfinance Credit Guarantee Facility (MCGF)

SBP vide circular No. 03 dated June 21, 2012 has decided to allow the microfinance providers to mobilize funding from non-bank sources/capital market in addition to Banks and DFIs under Microfinance Credit Guarantee Facility. The decision was made with a view to further ease the funding constraints of the microfinance sector.

Agent Network Management Workshop in LRC, SBP

Agricultural Credit & Microfinance Department, State Bank of Pakistan organized a workshop on Agent Network Development on May 31, 2012 at Learning Resource Center, SBP Karachi. The objective of the workshop was to review country case studies and develop a view on improving the agent network quality and other related matters in Pakistan. Mr. Gerry Rasugu was the visiting speaker. He is a renowned global expert on agents' network development. Mr. Rasugu shared his global experiences of developing agents network particularly in Kenya for M-Pesa. He also shared key findings from IFC's four market Branchless Banking study.

SBP issues License to Advans MFB

SBP has issued license to Advans Microfinance Bank to operate in Sindh Province. Advans SA is a French run Investment company, backed by investments from several Development Finance Institutions (DFIs) including the IFC, the European Investment Bank and official development agancies from France, Germany and Netherland etc. This is the first such operation set up by a foreign company in the country.

Pilot Project Phase IV

Encouraged by the successful completion of PP-III, SBP has launched Pilot Project Phase IV from Rabi season 2011 to deepen the outreach of agri. finance on fast track basis. PP-IV will cover 54 districts for farm and non-farm financing, while 22 districts will be especially targeted for group-based lending to small/ landless farmers. In this connection, respective targets in terms of number of borrowers, amount to be disbursed, amount outstanding, etc. to 16 participating banks were assigned.

Farmers Financial Literacy & Awareness Program on Agri. Financing

Cognizant of the lack of awareness & understanding of farming community about agri. finance products & services offered by banks, SBP in collaboration with commercial/microfinance banks, field offices of SBP-BSC and other key stakeholders has launched a country wide "Farmers Financial Literacy & Awareness Program on Agri. Financing" from April, 2012. In the pilot phase of the Program, 12 one-day training-cum-awareness seminars are being held in agri. intensive districts/ towns across Pakistan. During the first half of 2012, six programs have successfully been conducted in the tehsils of Bahawalpur, Ghotki, Nowshehra, Sanghar, Kotli (AJK) & Chitral Districts. These programs have been co-hosted by selected banks for the specific locations.

Policy Adequacy and Awareness Seminars on Agri. Financing

In order to acquaint agri. graduates about the basic structure of agri. financing, related policies, schemes, initiatives taken by SBP in recent years to enhance the outreach of agri/ rural finance, SBP, in collaboration with SBP-BSC, banks, microfinance banks and agri. universities/ colleges, arranged "Policy Adequacy and Awareness Seminar on Agri. Financing" at Agriculture University, Rawlakot, AJK on 10th May, 2012. The seminar was attended by a large number of students, teaching faculty, academia, Chief Manager of SBP-BSC, officials of DFSD, SBP-BSC and senior officials of banks.

Relief to Borrowers of Affected Areas

To provide relief to the borrowers of flood/ rain affected areas identified by the National Disaster Management Authority (NDMA), banks were encouraged to reschedule/restructure loans to such borrowers where the possibility of recovery exists.

Capacity building Program on Housing Finance

State Bank of Pakistan (SBP) is extending its endeavors to flourish the housing finance system in the country. Being the regulator of financial institutions, SBP is thriving hard to educate the financial industry. In continuation to SBP efforts, we actively pursue this goal of SBP to train the financial industry. During the FY 2011-2012, Infrastructure & Housing Finance Division conducted eight different training programs, related to mortgages, in different cities of the country which were highly appreciated by the participants. A training program on the topic "Issues in Housing Finance" was held in Quetta to create the awareness regarding the housing finance in the underdeveloped markets.

8.0. Development Finance News from around the World

The following key developments/news occurred during the quarter under review.

Centre of Excellence in Islamic Microfinance' Established

http://www.alhudacibe.com/pressrelease1.php

Centre of Excellence on Islamic Microfinance has been established in Lahore in order to provide Capacity Building, Shariah Guidance and capacity building to the Microfinance & Islamic Microfinance Institutions, considering its popular trend in poverty alleviation from the world. AlHuda-Centre of Excellence on Islamic Microfinance will be helping Microfinance Institutions in adopting the Islamic Microfinance system through the system development, Gap Analysis and Adoption routing.

Khushhali bank announces branchless banking initiative

http://www.dailytimes.com.pk/default.asp?page=2012%5C08%5C11%5Cstory_11-8-2012_pg5_14

Khushhali Bank Ltd. (KBL) is extending its partnership with Shore Bank International Ltd (SBI), to develop and roll-out KBL's branchless banking services in partnership with a national payment platform provider. By linking in with a leading existing digital payment platform, KBL will allow low-income customers to access not only savings, but also credit and other financial services over the platform, displacing cash over time and allowing customers to better manage their economic lives. The second phase of this project will allow KBL to offer its banking products through branchless banking channels, allowing it to expand penetration to the under banked and deepen access of financial services.

Ufone acquires 100% shares in Rozgar Microfinance Bank

http://www.thenewstribe.com/2012/07/23/ufone-acquires-100-shares-in-rozgar-microfinance-bank/

Ufone (Pakistan Telecommunication Company Limited) is in advanced stage of acquiring 100 percent share of Rozgar Microfinance Bank with the objective of enhancing microfinance business through rolling out their branchless banking setup in the country. Initially the cellular company decided to acquire bank's major stakes but it subsequently decided to buy complete bank after negotiation with the management of Rozgar Microfinance Bank.

Financial inclusion: India scores poorly on global stage

http://www.business-standard.com/india/news/financial-inclusion-india-scores-poorlyglobal-stage/484232/

India had scored poorly on financial inclusion parameters when compared with the global average, said the Reserve Bank of India in its annual report. India scored poorly in respect of credit cards, outstanding mortgage, health insurance, adult origination of new loans and mobile banking. "Financial inclusion remains a substantially unfinished agenda," said the report.

Growing trend of Govts adopting e-payments methods: MasterCard

http://articles.economictimes.indiatimes.com/2012-08-29/news/33476375_1_direct-express-debit-card-financial-inclusion-social-security

Governments world over are increasingly adopting electronic payment methods as an alternative to cash and cheque-based benefit programme, as a measure to save money and improve financial inclusion. The United States, Italy, Canada, United Arab Emirates and Romania are some of the latest examples of governments going paperless as a cost-savings opportunity and a method of addressing financial inclusion, MasterCard Worldwide said in a statement. Most recently, the South African Social Security Agency distributed more than 2.5 million debit cards to social grant recipients across the country with a target of 10 million cards by March 2013, the statement added. According to Mastercard, the United States Department of the Treasury is also moving towards all electronic payments, including the Direct Express debit card, which is used to deliver social security and other federal benefits. The programme is expected to save the US government USD 1 billion over the first ten years.

First-ever mobile bank going strong in Philippines

http://www.atmmarketplace.com/article/200527/First-ever-mobile-bank-going-strong

Philippine FI BPI Globe BanKO Inc., the world's first mobile phone-based bank, expects to reach the million-client milestone in 2013. BanKO was created by Bank of the Philippine Islands, mobile carrier Globe and holding company Ayala. The venture launched this January and has enrolled 200,000 customers to date, exceeding initial expectations. To open a BanKO account the customer goes to an agent (these include convenience stores, gas stations and pharmacies, among others), registers his mobile number and makes an initial deposit to the new account. The customer later receives an ATM card. BanKO customers can pay bills and remittances, and apply for micro-loans and insurance. Cash withdrawals and deposits can be made either by ATM or at an agent location.

Planning Commission seeks to computerize, centralize land records

http://www.thenews.com.pk/Todays-News-3-103509-Planning-Commission-seeks-to-computerise-centralise-land-records#

The Planning Commission wants to computerize the land records and centralize the data collected from all over the country in next few years, the action plan on Growth Strategy prepared by the commission said.

Rise of the Pakistani middle class: Affluent buyers demand 'lifestyle real estate'

http://tribune.com.pk/story/368158/rise-of-the-pakistani-middle-class-affluent-buyers-demand-lifestyle-real-estate/

Middle class homebuyers in urban Pakistan are increasingly demanding better facilities and real estate developers are increasingly competing not just on price but also on the quality of communities they can build.

Real estate is becoming an increasingly important sector for the Pakistani economy, employing well over 5% of the country's labor force directly in construction and much more in related industries. Yet a key hindrance to the development of the sector is the availability of housing finance.

SBP urged to launch First Home Mortgage Schemes

http://www.nation.com.pk/pakistan-news-newspaper-daily-english-online/business/29-Apr-2012/sbp-urged-to-launch-first-home-mortgage-schemes

No proper efforts are being made by the government or the State Bank to increase housing supply and improve the overall conditions in housing as well as housing finance market, as there is acute housing shortage, particularly for lower income groups, which make up a substantial part of the population.

This was stated by Mian Ayaz Anwar, the Managing Director of the Zaitoon Group, a real estate development company, during an interview with The Nation. He observed that it is responsibility of the State Bank of Pakistan to launch a First Home Mortgage Scheme on marginal interest for all income groups to bridge this gap of demand and supply.

Troubled sector: 300,000 units added to housing backlog every year

http://tribune.com.pk/story/381491/troubled-sector-300000-units-added-to-housing-backlog-every-year/

The housing shortage in Pakistan goes up by 300,000 units every year, with the cumulative national housing backlog of at least seven million units, according to the International Housing Finance Programme 2008. Yet, the State Bank of Pakistan estimates that the formal financial sector caters to only 1% to 2% of all housing transactions in the country.

EAC proposals: Banks may be offered tax breaks on concessionary house loans

http://tribune.com.pk/story/384252/eac-proposals-banks-may-be-offered-tax-breaks-on-concessionary-house-loans/

The Economic Advisory Council (EAC) – an economic policy advisory body – has offered its proposals for the upcoming financial year to Finance Minister Dr Abdul Hafeez Shaikh during a meeting here on Friday.

EAC suggests incentivizing housing and small and medium enterprise (SME) loans; introduction of major tariff reforms; and uniformity in sales tax rates as focal points for the government.

USAID helps Water & Power Ministry enhance capacity

http://tribune.com.pk/story/318855/energy-crisis-usaid-launches-training-program-for-power-sector-employees/

The United States Agency for International Development (USAID) has started a capacity-building training course for engineers and trainees to help them gain a deeper insight and resolve system problems in the power transmission network. The training programme comprises a beginner course for junior engineers and an advanced course for experienced and senior engineers.

Anti-poverty unit to fund 109 infrastructure projects

http://tribune.com.pk/story/304455/building-capacity-anti-poverty-unit-to-fund-109-infrastructure-projects/

The Pakistan Poverty Alleviation Fund (PPAF) announced to provide Rs. 238 million grant to finance 109 small-scale community development schemes in the poorest areas of the country. The development program would benefit over 40,000 marginalized communities in the districts of Rajanpur, Layyah, Dera Ismail Khan and Khyber Agency. This financing would be used for small-scale infrastructure, water, energy, livelihood enhancement and protection and capacity-building schemes in four districts. The assets would be transferred to the poor and ultra poor community organizations to sustain their livelihood while capacity-building trainings would also be imparted to the marginalized communities.

Pakistan urges Korean Investment

http://www.brecorder.com/pakistan/business-a-economy/57125-korea-urged-to-enhance-investment-in-pakistan-.html

Secretary Industries urged South Korean Ambassador to enhance Korean investment in Pakistan. "The Korean investment in Pakistan is much lower than its potential which in 2010-2011 stood at $ 7.7 million", Aziz Bilour said here in a meeting with Ambassador of Korea in Pakistan Choongioo Choi on Friday. Both discussed the prospects of enhancing investment in the energy, steel, consumer goods, domestic appliances, electronics, auto sector and relocation of Korean industries in Pakistan.

Power companies: Management control to be outsourced

http://tribune.com.pk/story/276916/power-companies-management-control-to-be-outsourced/

In order to enhance efficiency of nine public sector power companies, the government has decided to outsource their managements, operations, maintenance and rehabilitation, including conversion to cheaper fuel, to the private sector, said Managing Director of Private Power and Infrastructure Board (PPIB) NA Zuberi. Zuberi said that among these power companies one each is located in Jamshoro, Kotri, Quetta, Guddu, Muzaffargarh, Multan, Shahdara and two in Faisalabad.

Germany has started more than 14 projects in Pakistan

http://tribune.com.pk/story/446578/germany-has-started-14-projects-so-far/

Consul General of Federal Republic of Germany in Pakistan said his country had started more than 14 projects in Pakistan**.** Speaking at a reception held in connection with celebration of the Day of German Unity at the consulate, the German consul general said it was his earnest desire to see Karachi regain its rightful place as the city of lights and said that Pakistan can always work with Germany to improve its infrastructure. He said Germany had started several alternative energy and infrastructure projects to contribute to Pakistan's development.

Lack of Infrastructure in Pakistan, President ICCI

http://www.pakistantoday.com.pk/2011/07/22/news/profit/lack-of-infrastructure-in-pakistan-says-president-icci/

Cost of doing business in Pakistan has increased tremendously due to lack of infrastructure facilities putting strains on the growth of trade and industrial activities. The government should involve private sector by moving to public-private partnership in order to develop the country's infrastructure at a fast pace, President Islamabad

Chamber of Commerce and Industry (ICCI) Mahfooz Elahi said on Thursday. He said private investment in infrastructure projects has declined over the years and no major infrastructure project has been completed in the country on a Build-Operate-Transfer (BOP) basis

ADB's first Shariah-compliant project financing

http://www.iflr.com/Article/3039391/ADBs-first-shariah-compliant-project-financing-explained.html

The Asian Development Bank (ADB) has participated in its first Shariah-compliant project financing for two wind farms in Sindh province, Pakistan. But the use of Islamic financial instruments was not ADB's first option.

Though ADB has previously provided conventional debt alongside Islamic finance, this is the first time that all aspects have been Shariah-compliant. ADB granted two partial credit guarantees worth up to $66 million to the Islamic Development Bank (IsDB), which then financed the project under an *ijarah structure*. A consortium of Pakistani banks provided the remainder via a *musharakah structure* with a term of 12 years.

Islamic project finance will rise to $30b by 20

http://www.alhudacibe.com/newsletter/1-15nov/international_news_5.html

Islamic project finance deals are projected to reach $30 billion by 2012, representing up to 30 per cent of all major structured deals finalized in the Middle East, according to the Islamic Project Finance Report released by the Middle East Economic Digest (MEED). The driving force behind the development of the Islamic project finance market has been the economic boom in the GCC, brought about by strong oil prices, states the report. High rates of economic growth coupled with record balance of payments surpluses are fuelling unprecedented liquidity in the regional banking market

9.0. Special Section – a case for Infrastructure Development and Financing institution in Pakistan

Infrastructure – A Necessity

Infrastructure is the fundamental requirement in the functioning of any country. In today's modern era, we need electricity to power our homes and industry. Roads are needed for transporting goods from one place to the other and then ports and airports to export our industrial products to foreign trade partners. Similarly, a modern nation requires effective water and sanitation to improve and sustain the health and cleanliness of its people. In all situations, infrastructure is such a necessity that it affects the lives of every single individual on this planet. Lack of proper infrastructure causes chaos and havoc in our lives. It also causes bottlenecks in the smooth functioning of the economy.

Pakistan Infrastructure Scenario: Pakistan's infrastructural situation is relatively poor by international standards and this has a significant impact on the lives of every Pakistani in the country. Acute shortage of electricity has turned this necessity into a luxury. Large portion of population do not have access to proper drinking water and sanitation facilities. The Government of Pakistan and its people face an uphill battle against poor infrastructure and it seems like the latter is winning as the country is going through the worst power crisis in its history, with electricity shortage of 4000 MW. With an estimated 5% annual growth in demand, the country would need additional capacity of approximately 10,000 MW by 2016.

The improvement and expansion of infrastructure is a pre-requisite for sustaining and accelerating economic growth and social development in a country. Improving quality and service coverage in power, water supply and sewerage treatment, transport and logistics is crucial for Pakistan's economy and to improve the quality of life.

It is estimated that due to insufficient infrastructure, Pakistan looses about 4 to 6 percent of its GDP (approximately $6 billion). Logistical bottlenecks increase the cost of production of our goods by about 30 percent. This has a significant impact, as Pakistan is facing stiff competition from the likes of India and China in the export markets. To improve and expand infrastructure, Pakistan's needs are massive and its resources are limited. Not only is there limited fiscal space, there are also huge gaps in public sector capacity to build and operate infrastructure.

Capital Market: Trading in securities enables a match between the differing maturity preferences of lenders and borrowers. Stock markets provide the platform for broad based ownership of financial assets and the reallocation of funds among different sectors. Moreover, a developed bond market helps in providing liquidity to domestic growth and credit expansion. The stock markets in Pakistan posted good gains and the KSE-100 index gained 11.6% by mid of April 2008 and reached the highest level of 15,676 points. Subsequently, however, the equity market has seen precipitous decline. Prices have nose-dived in response to waning macro-economic fundamentals, worsening law and order situation and international capital flight. Equity investors have seen a fractional recovery of fortunes with an upsurge in the KSE-100 index of 22.5% since the commencement of calendar year 2009.

The Debt capital market is at an early stage of development and the size is not very large. Pakistan needs a viable bond market in order to mobilize private savings efficiently for long term investments. Additionally, a sizeable portion of government's financing needs is met by raising funds through Pakistan Investment Bonds (PIBs).

Infrastructure Development – A Global Trend: While Privatization and PPPs in Infrastructure are relatively recent in origin, starting in much of the Developed world only in the 1980s, the developing world followed suit almost simultaneously (e.g., Chile). The global experience with both privatization and PPPs has been generally favorable. However, there are instances of flaws in the design of PPP contracts, as a result of which a trend to rising subsidies appears to become entrenched, negating any long term benefit to public finances or public reaction to too early tariff adjustments leads to the cancellation of privatization and PPP programmes. Such outcomes have been seen in both the developed and in developing countries.

Infrastructure Development in Pakistan – A Changing Scenario: Historically, infrastructure projects have been mainly in the government domain. Governments have managed, financed, owned and operated these projects. However, given the budgetary pressures on the governments, and an inability to manage these projects efficiently, government is now encouraging the private sector to play a greater role in building and managing infrastructure projects.

The government estimated that less than half of the infrastructure investment can only be covered by the public funds under the Last Medium Term Development Framework (MTDF). The rest of the investment was targeted to be attracted from the private sector by providing a combination of policy reforms, institutional support, incentives and financing modalities. In order to fill the investment gap for infrastructure development, the best available option is *public private partnership (PPP).* A typical example of PPP is a contractual arrangement under which a private party agrees to finance, construct and operate a facility for an agreed period of time and transfer the facility to a government or other concerned public agency on expiry of the stipulated period.

Outside power generation, Pakistan has not yet developed policy frameworks for progressive PPPs in Infrastructure sectors. It would hence be useful to review the evolving international scenario of PPPs in Infrastructure, to identify guidelines for creating sustainable interest of private investors, operators and financiers.

Challenges to Infrastructure Financing in Pakistan

A number of factors pose challenge to the development of infrastructure project finance market:

- Transaction amount in the infrastructure/ power sector is sizable compared to the per party exposure constraints of many banks in the sector;
- Other than the big five, local banks are still in the process of familiarizing themselves with infrastructure project financing and are still reluctant to undertake long term payback ventures;
- Lack of confidence of the banks in the power sector due to circular debt issue and persistent delayed payment by public sector entities;
- Limited availability of specialized project finance expertise within commercial banks;
- Insufficient long-term debt instruments available in the capital markets.

Need and Scope of Infrastructure Development and Financing Institution (IDFI)

Need of IDFI: The infrastructure services in Pakistan is characterized by unsymmetrical growth in relation to economic growth and matters take a grave tone with banks lack of capacity / technical expertise for financing infrastructure projects. Banks are also constrained by Asset / Liability mismatch as most of the deposits are of short tenor. Local banks need risk sharing mechanism for sustainable development in infrastructure sector which eventually reduce reliance on foreign currency funding to lower the risk of exchange rate exposure which in turn will have positive impact on Balance of Payment. Most Emerging Market countries have created national organizations dedicated to developing PPP projects and enabling their commercial financing through appropriate credit enhancement techniques. Although GoP has established Infrastructure Project Development Fund ('**IPDF**') with the aim of developing legal and regulatory framework for improved project implementation and infrastructure development, the fund does not have the mandate to support private sector initiated projects. Further, the initiative is yet to take off since IPDF to date has not undertaken any major projects yet and the financing arm i.e. IPFF is still not functional.

Scope of IDFI: The role required of an Infrastructure Development and / or Financial Institution very much depends on the stage and momentum of infrastructure development in a country. In a country like Pakistan the backlog is significant, where the 'originating' capacity within the public sector is absent, where commercial or development banks have not developed models and practices suitable to raising the substantial and long term funding needed, it would be most desirable to have institutions that could both originate and finance projects, as described above.

IDFI will therefore perform a broad array of activities:

- Project Development

- Need identification, research studies on successful international models, conceptualization, pre-feasibility reports, commercial viability aspects, identification of potential investors
- Project Structuring
- Use of innovative structural / financial techniques to enhance project viability
- Project design
- Project tender
- Project Financing
- Equity participation
- Loan syndication
- Core funding
- Credit enhancement
- Project Implementation / Other services
- Facilitate access to Viability Gap Fund
- Tariff and other advisory services
- Facilitate coordination of project sponsors with relevant ministries and government departments
- Performance monitoring
- May help government in PPP policy formulation

The IDFI will have commercial considerations as it should provide fair returns to its equity holders by targeting projects with high economic paybacks and earning a spread on its lending. IDFI would also facilitate projects in infrastructure sectors, not having precedence of private sector involvement and are in need of huge seed capital with long gestation period by providing access to VGF. Though there is a huge potential in the entire infrastructure sector, it is proposed that IDFI will initially focus on priority sectors including Power, Special Economic Zones, Agriculture Infrastructure including warehouses, cold chains, etc. and water purification. Other sectors like road, railway and port etc. can be considered later on subject to capacity enhancement.

Conclusion

As elaborated in detail, to match the growth of country's GDP, it is necessary that there should be an institution for infrastructure support that should not only be able to finance infrastructure PPP projects but should also work on advisory, initiation, implementation and monitoring of various critical projects. Principle buy-in of the government has been obtained in setting up of such an organization. Benefit from recent successful international experiences would be drawn while setting up as well as while running the institution. Equity would available from government as well as local financial institutions (banks and DFIs). Multilateral organizations are also expected to participate in equity injection as well as long-term soft loans. Local as well foreign investors would be interested in taking up new infrastructure projects when a specialized institution would be available under a PPP set-up. The technical experts as well financial experts would be engaged to effectively run the institution in a sustainable manner.

10.0. Development Finance - Outlook

Although Pakistan is facing various challenges, there exists a strong reason for a positive course of action to take place since the huge potential of the DF sectors itself is a highly motivating factor to encourage the stakeholders to tap on, and consequently develop it for the benefit of economy and their own business interests.

The State Bank, on its part, has taken various important initiatives for the development of the DF Sectors that will cause positive impact on the availability of funds for the sectors and their overall development in the long run. Some important initiatives include improvements in Credit Guarantee Scheme for Small & Rural Enterprises, Refinance schemes for flood affected districts, Microfinance Credit Guarantee Scheme, Refinance Scheme for Revitalization of SMEs, Scheme for modernization of SMEs, Cluster Profiling Surveys, introduction of Branchless Banking, Capacity Building and Awareness Programs for the stakeholders.