Development Finance Quarterly Review

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Infrastructure, Housing & SME Finance Department,

State Bank of Pakistan, Karachi

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Executive Summary

Energy shortages, poor law & order situation, and difficult financial position of the government due to spending on war against terrorism and IDPs resulted in a real GDP growth that is substantially lower than the long-term average in the preceding four years. The impact of these domestic factors was compounded by the declining FDI due to domestic law and order. The poor performance of the economy during 2010-11 was further exacerbated by the floods in the country. In such a scenario of economic down turn, the Development Finance (DF) outstanding amount witnessed a decline of 1.9 percent on YoY basis and 2.7 percent on QoQ basis. (**Table 1**)

Table 1: DFG Wise Break up of Outstanding Amount (Rs. Billions)								
Sector	**March,2010**		**Dec,2010**		**Mar,2011**		**Change**	
	Amount	**Share**	**Amount**	**Share**	**Amount**	**Share**	**QoQ**	**YoY**
SME Finance	326.0	38.0%	334.0	38.7%	303.0	36.0%	-9.3%	-7.1%
Agriculture	166.3	19.4%	168.5	19.5%	164.9	19.6%	-2.1%	-0.8%
Microfinance (MFBs Only)	9.4	1.1%	10.0	1.2%	10.7	1.3%	6.9%	13.8%
Housing Finance	71.8	8.4%	67.0	7.8%	65.4	7.8%	-2.3%	-8.9%
Infrastructure Finance	283.7	33.1%	284.5	32.9%	296.5	35.3%	4.2%	4.5%
Total	**857.2**	**100.0%**	**864.0**	**100.0%**	**840.6**	**100.0%**	**-2.7%**	**-1.9%**

A disaggregated analysis shows a decline in outstanding loans under SME finance, Agriculture and Housing finance. In contrast, Micro and Infrastructure finances showed a positive growth in their outstanding lending defying overall trend in the DF. The decline in DF is owed to both demand and supply factors. On supply side, banks' risk appetite remained subdued due to rising NPLs and aggressive government borrowings for fiscal and quasi fiscal needs capturing the major chunk of the available funds with banks and crowding out the private sector. On demand side, DF could not flourish due to high interest rates, power outages, deteriorating security situation, and uncertainty over major changes in taxation policies.

The number of borrowers fell by 4.5 percent in the overall banking industry. DF sector was not an exception, as its total number of borrowers declined by 5.0 percent on YoY basis dropping to 2,050,334 (excluding Infrastructure borrowers). Agriculture sector saw more than 50 percent decline. Anecdotal evidence suggests that increased farm income on the back of high commodity prices and credit sharing by the buyers of agriculture output moderated the credit demand of the small farmers.

NPLs of the whole banking industry rose by 13.5 percent during the reporting period. The rise in NPLs in DF sectors was even more pronounced and rose to Rs. 163.9 Billion, up by 21.2 percent on YoY basis. Of the total NPLs of DF Sectors, SME had 61.7 percent, Agri. Sector 20.3 percent, and the remaining 18 percent related to other DF sectors. The rise in DF NPLs may be attributed to the prevailing economic slowdown and floods in extended areas.

1.1. SME Finance

Small & Medium Enterprises (SMEs) are considered engine of economic growth in any country due to employment generation, contributing in equitable distribution of wealth, and fostering entrepreneurial culture.

At the end of March 2011, SME sector's outstanding credit stood at Rs. 303.4 billion constituting about 8.6 percent of total outstanding banking portfolio (corporate, SME, agriculture, consumer, commodity and others). This was 9.3% lower from the previous quarter and 6.3% from the corresponding period in 2010. A rise in NPLs of SMEs by 4.7% (QoQ) shows banks' cautious lending behavior. Credit flow to SMEs has been declining since 2008 (after the liquidity crunch in Q4-2008) as banks diverted funds towards less risky commodity operation of the government as well as investing in T-bills. In addition, high interest rate, rising inflation, energy shortage, and gradually increasing energy costs have also dampen the demand for bank credit by SMEs. Consequently, number of borrowers in SME sector declined by 6.4% at the end of March 2011.

Enterprise-wise analysis revealed that trading SMEs' share in total SME outstanding was 44.1%, m*anufacturing SMEs'* share was 38.8%, and *services* SMEs 17.1% at the end of the period under review. Moreover, their respective share in the total SME borrowers was 50.3%, 17.0%, and 32.7% respectively, indicating largest average loan size in manufacturing sector.

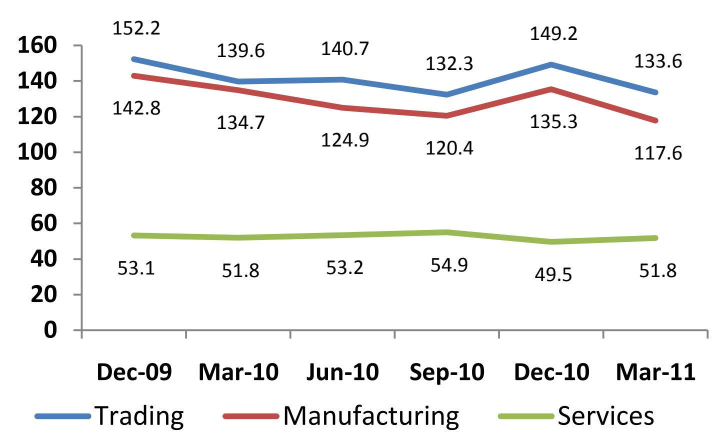
There has been a rise in NPLs of the overall banking industry during the last couple of years and this quarter, too, saw a rise of about 13.5%. However, NPLs of SME Sector rose by 4.7% only on QoQ basis. This is probably a function of well diversified portfolio of relatively smaller loan size and of better monitoring.

1.2. Outstanding Amount- Break-Ups

Enterprise wise Break-up

At the end of March 2011, a sector- wise break-up reveals that the fall in outstanding amount in overall SME finance was driven by a fall in lending to manufacturing and trading sub-sectors. In contrast, services sub-sector showed remarkable resilience and outstanding amount under this sub-sector posted a rise of 4.5% on QoQ. However, it could not offset the impact of fall in the other two sub-sectors.

Fig 1a: Outstanding Amount: Enterprise-wise



It is important to note that a decline in lending to trading is mainly attributed to fall in both export finance for SMEs Part-I and trade finance for SMEs (other than export refinance) during this period. It suggests that demand for relatively unrestricted concessional financing remained strong; since export finance Part-I is based on LCs, and Part-II is based on performance.

Tenor wise

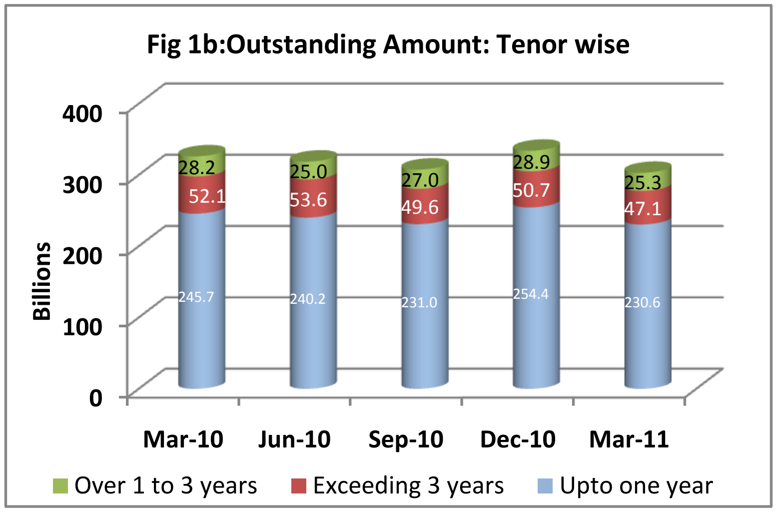
Tenor-wise breakup of the total SME outstanding amount showed that the dominating share of about 76.1% was availed by SMEs under the category of *short term* financing (up to one year), while the share of l*ong* and m*edium* term financing was 15.5% and 8.4% respectively. At the end of March-2011, SME financing for all tenors declined relative to the preceding quarter; however, the impact was more prominent in the case of medium term financing.

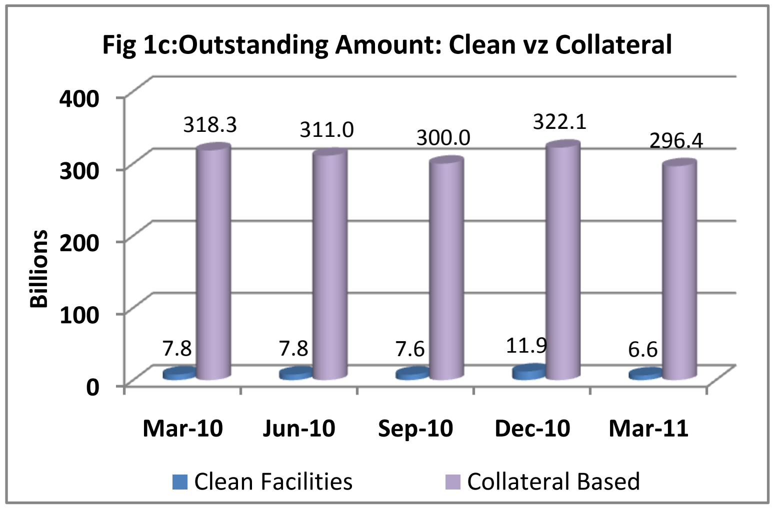
It is evident from **Figure 1b** that the major chunk of the financing continues to be under short term financing as SMEs require short term funds more frequently to smooth out cash flows from operations. This is also consistent with the substantial share of financing for working capital. However, a fall in short-term financing is discouraging given a significant rise in commodity prices.

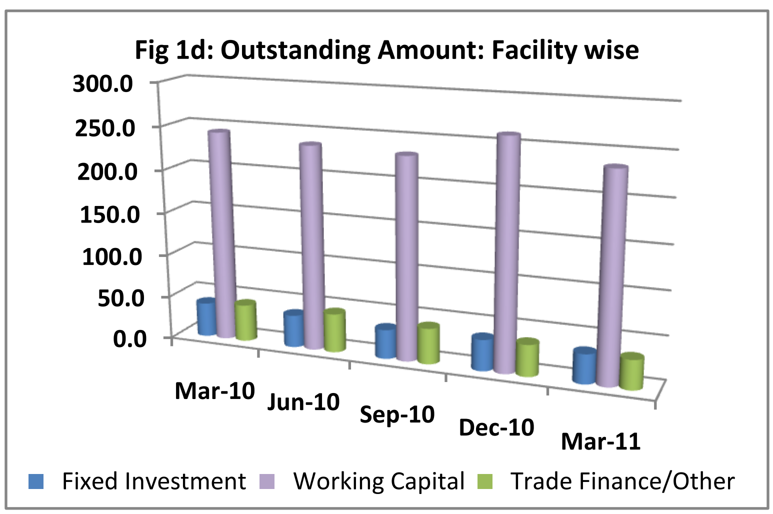
Clean vs Collateral

The breakup of the SME outstanding amount viz-a-viz **clean** and **collateral** revealed that the major chunk of financing (97.8%) was made against collateral while only 2.2% of the SME outstanding amount was provided as clean lending category-**Figure 1c.**

The meager share under clean lending reflects (a) the banks mindset of relying on security/collateral while lending to SMEs (b) a lack of innovative products and borrower evaluation techniques whereby borrowers' repayment capacity is judged through business/cashflows assessment instead of asset/collaterals.







Facility- wise

At the end of March 2011, facility-wise breakup exhibited that the share of working capital in outstanding SME amount was 77.6%. The remaining financing was equally shared by fixed investment and trade related purposes (**Figure 1d)**. To achieve a rapid and sustainable growth of SME sector, there is a need to encourage SMEs to increase fixed investment with the introduction of feasible and innovative financing products by both traditional and Islamic banks. It is also important to note that the efforts of the financial sector will not be successful unless complemented by the government's concrete efforts to improve infrastructure (particularly resolution of energy shortages) and law & order situation.

Table 1A: Outstanding Amount: Loan Size wise Breakup (Rs. Billions)

Breakup	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	% Share (Mar-11)
Advances up to 0.5 Million	22.0	21.2	20.0	18.4	16.9	5.6%
Advances over 0.5 to 1 Million	11.9	12.9	12.6	13.2	13.0	4.3%
Advances over 1 to 2 Million	20.4	21.4	20.8	21.6	21.1	7.0%
Advances over 2 to 3 Million	17.0	17.9	16.3	16.3	16.4	5.4%
Advances over 3 to 5 Million	29.2	30.5	28.5	30.4	28.5	9.4%
Advances over 5 to 10 Million	50.6	52.4	51.7	55.7	51.4	16.9%
Advances over 10 to 20 Million	50.0	50.5	48.6	54.9	52.2	17.2%
Advances over 20 Million	124.9	112.0	109.1	123.6	103.7	34.2%
Total SME	**326.12**	**318.77**	**307.59**	**334.00**	**303.01**	**100.0%**

Size- wise

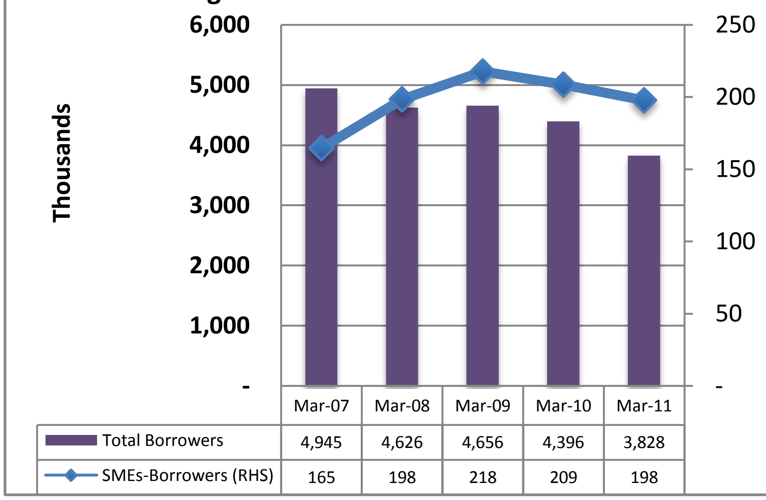
A size- wise loan breakup (**Table 1A**) depicts that the major chunk, of about 68.4%, in total SME Outstanding portfolio was availed by SMEs against the bracket size of loans of over 5 million. While the share of SMEs against the bracket size of up to 1 million was about 9.9%. It is interesting to note that while all loan categories witnessed a decline in outstanding amount during March 2011(QoQ), category of advances over Rs. 0.5 to 1.0 million registered an increase of 3.7 percent.

1.3. Number of Borrowers

At the end of March 2011, total number of SME borrowers stood at 197,808 constituting about 5.2% of the total number of outstanding borrowers of the banking industry and recorded a quarterly decline of about 6.4% (**Figure 1e**). It is a source of concern that the decline in number of SME borrowers is significantly higher than the overall reduction of 2.1 percent in the number of borrowers of total banking industry.

Of the total SME borrowers, about 89% availed working capital finance, 5% fixed investment, and 6% trade finance. Likewise, the the share of the borrowers categorized as *trading SMEs* was the highest with 50.3%, followed by ***s**ervices SMEs* with 32.7% and *manufacturing SMEs* with 17.0% at the end of the quarter under review.

Fig 1e: SME Borrowers vs Total Borrowers

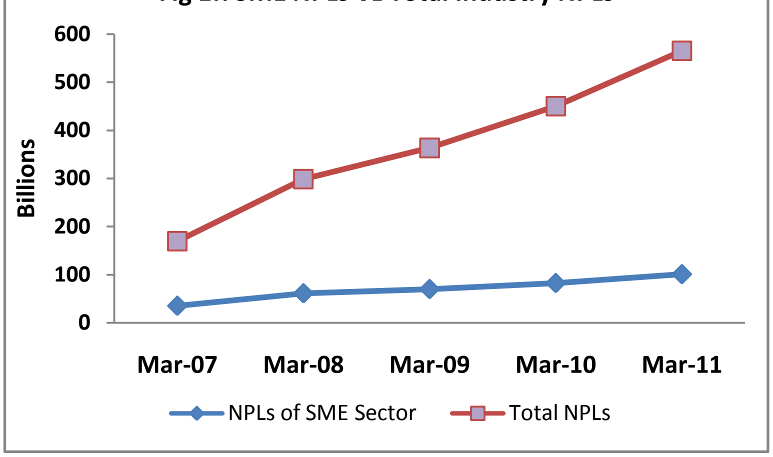


In the same way, an analysis of *loan size* wise borrowers manifest that 71% of total SME Borrowers fell under the bracket size of *up to Rs. 0.5 million* followed by over *Rs. 0.5 to 1 million, Rs. 1 to 2 million, Rs. 2 to million,* and *over Rs. 3 to million* had a share of 8.2*%, 6.5%, 3.1%, and 3.5%* respectively. This is consistent with the above information that the concentration of SME finance is largely for working capital purposes.

1.4. Non Performing Loans

Non- performing loans (NPLs) of SME Sector increased from Rs. 96.5 billion at the end of Dec-10 to 101.1 billion at the end of Mar-11, up by 4.7 percent. However as a result of a stronger rise in NPLs of the overall banking sector, share of SME NPLs in total dropped from 19.4% in Dec-2010 to 17.9% by Mar-2011.

Fig 1f: SME NPLs Vz Total Industry NPLs



A closer look at the behavior of SME sector's NPLs reveal that there has been a consistent rise since March, 2007 (**Figure 1f**) mainly attributed to economic slowdown, intensification in energy crisis and deterioration in security situation.

1.5. Banking Group Wise Distribution

At the end of the period under review, the share of *public sector banks***,** i.e., NBP, FWBL, BOP, BOK, and Sindh Bank constituted 13.4% of the total SME outstanding amount **(Table 1B**), slightly lower than the 13.5 percent recorded in the preceding quarter. Their share in total NPLs of SME sector remained unchanged at 17.1 percent at the end of the period under review. This indicates that despite a sharper decline in outstanding amount, rise in NPLs of public sector banks was in line with the performance of overall SME sector.

Private Banks (19 institutions) share in total SME loans outstanding was 82.0%. Their outstanding amount in absolute terms was Rs. 248.4 billion. Of the total SME Outstanding, among ***private banks,*** HBL had the highest share of 15.6% followed by ABL with 8.4%, Bank Alfalah with 8.2%, and NIB with 7.9% respectively. This category of banks contributed about 9.8% of their overall outstanding portfolio towards SME sector. However, unlike public banks, private banks dominant share in SME outstanding amount remained intact, but their share in SMEs NPLs increased from 73.6 percent in Dec-2010 to 74.1 percent by Mar-2011.

Table 1B: Banking Sector wise Distribution- As of March 2011

Category	**% Share of SME in**			**% Share in**			**Quarterly Change**		
Bank	Total O/S Amount	Total O/S Borrowers	Total NPLs	SME O/S	SME Borrowers	SME NPLs	Amount	Borrowers	NPLs
Public	6.1%	6.5%	10.4%	13.4%	32.6%	17.1%	-9.8%	-2.9%	4.6%
Specialized	8.5%	4.7%	25.2%	3.2%	19.5%	7.8%	-1.5%	-0.1%	0.3%
Private	9.8%	4.9%	22.2%	82.0%	47.6%	74.1%	-9.3%	-11.0%	5.5%
Islamic	3.8%	2.5%	7.8%	1.1%	0.3%	0.6%	-18.8%	-5.3%	-21.9%
Foreign	0.8%	0.1%	3.8%	0.2%	0.0%	0.3%	-4.5%	-5.9%	21.0%
DFIs	0.6%	0.9%	0.6%	0.1%	0.0%	0.1%	-4.9%	-4.3%	7.6%
Banks	8.7%	5.2%	18.4%	99.9%	100.0%	99.9%	-9.3%	-6.4%	4.7%
Total	**8.6%**	**5.2%**	**17.9%**	**100.0%**	**100.0%**	**100.0%**	**-9.3%**	**-6.4%**	**4.7%**

Islamic banks' absolute amount outstanding at the end of March, 2011 was Rs. 3.5 billion constituting about 1.1% of the total SME outstanding amount. This category of banks witnessed a quarterly decline of 18.8% and 5.3% in SME outstanding amount and borrowers respectively. However, their NPLs recorded a decline of 21.9% at the end of the period under review. The low share of Islamic banks towards SME Sector is primarily due to the fact that the major chunk (87%) of Overall Portfolio is occupied by corporate and consumer sectors. However, given a sizeable share of trade related financing in SME sector, enormous opportunities for expansion for the Islamic banks are available in this segment.

Specialized banks category consists of SME Bank, ZTBL, PPCBL and IDBP. The absolute outstanding amount of this category towards SME sector was Rs.9.7 billion, as of Mar-2011, constituting about 3.2% of total SME financing. Their portfolio has been hovering around Rs. 10 billion for the last few years and did not witness any significant improvement, mainly on account of the diversion of their major chunk (84.8%), contributed mostly by ZTBL, towards agricultural sector. However, it is encouraging that NPLs of this group, in absolute amount, did not change during the period.

A negligible share of *Foreign banks'* and *DFIs* in SME finance suggests that these institutions in particular, and banks in general need to take cognizance regarding the significance of priority sectors in terms of a huge untapped market. Banks need to take innovative measures, besides building their capacity, in order to target the SME market in an effective way like when assessing comparatively small and straightforward business applications, banks may largely rely on standardized credit scoring techniques and also centralizing/rationalizing business-banking operations may significantly reduce processing costs. Furthermore, standardized computer-based assessments may also be more accurate and transparent than relying on personal judgments. As a result, banks may be able to offer more loans, faster and in larger amounts besides reducing previously high security requirements.

It is important to note that a vibrant SME sector would help sustain strong economic growth that would support future growth of the overall financial sector as well.

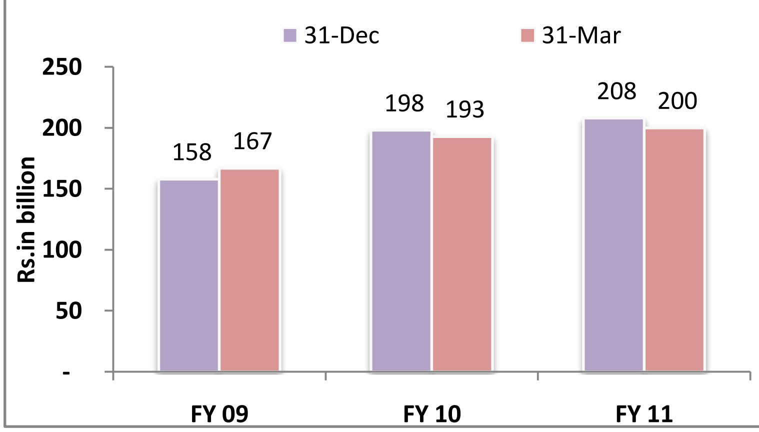
1.6. SBP Refinance Schemes

During the quarter, State Bank of Pakistan took a number of measures in order to support economic activities in war affected areas, and to facilitate the exporters in meeting their financing requirements. In line with government's fiscal relief package, SBP announced a procedure for reimbursement of subsidy on account of write off of loans outstanding as of December 31, 2009 for the borrowers of Malakand, Swat, Buner, and Chitral districts. The 2nd installment of the mark up rate subsidy for KPK, FATA & PATA has been released under the same relief package.

In order to meet the growing demand of LTFF by stakeholders, SBP increased the per project maximum borrowing limit to Rs. 1.5 billion from Rs. 1.0 billion and also included the exportable goods of glass sector under eligible sectors' category. Under EFS, SBP extended the waiver for further six months for the purpose of availing financing by those exporters having overdue export proceeds at the time of availing the facility.

During the quarter under review, banks were allocated 10% higher limits (Rs. 251 billion) compared to the same quarter of 2010 (Rs.228 billion) under the Export Finance Scheme. At the end of the quarter, Rs. 200 billion were outstanding under the scheme compared to Rs.193 billion for the same period last year. Commodity-wise and borrower- wise analysis under EFS financing continues to show skewed distribution. Out of total credit extended under EFS, 63% was outstanding against the textile sector. Out of 1,705, top 300 borrowers are availing up to 87% of the total financing under the scheme.

Fig 1g: Outstanding Financing Under EFS



As on March 31, 2011, Rs.23.9 billion was outstanding against the financing provided under the long term financing facility for plant & machinery (LTFF). Under the defunct LTF-EOP scheme, Rs. 18.6 billion was outstanding making the total financing under the long term schemes to Rs. 42.5 billion.

1.7. Export Finance Scheme (EFS)

SBP provides financing facilities for meeting working capital requirements of the exporters under Export Finance Scheme (EFS). In order to meet the exporters demand, in view of the growing prices of raw material specially cotton & yarn, the limits of banks under EFS for the third quarter of FY 2010-11 were increased from Rs. 242 billion to Rs. 250.5 billion (**Figure 1g**). Now, the total outstanding financing under EFS stood at Rs. 200 billion, showing an increase of 4 % on YoY basis

1.7.1. Banking Group-Wise Utilization

Private sector banks remained the major participants in the export finance despite decline in their share from 86.5 percent in Dec-2010 to 85.5 percent by Mar-2011. In contrast, as a result of a marginal increase in outstanding amount of public sector and Islamic banks, their share in total SME financing improved. The decline of Rs. 9 billion over the preceding quarter by private sector banks was due to maturity of loans availed in the month of September and October 2010 (**Table 1C**).

Table 1C: Banking Group Wise Outstanding

Banking Group	Dec-10	March-10	March-11	Δ YoY
	(Rs in Billions)			%
Public Sector Banks	12	11	13	18
Private Banks	180	168	171	2
Islamic Banks	6	5	7	40
Foreign Banks	10	9	9	0
Total	**208**	**193**	**200**	**4**

1.7.2. Commodity-Wise Distribution

Commodity-wise outstanding financing (Rs. 200 billion) shows textile sector at the top with Rs.126 billion (63.1%) followed by edible goods with Rs 27 billion (13.6%). Both sectors showed decrease of 3.0% and 9.0% respectively, compared to Dec-2010 quarter. This decline is reflective of overall decline in the amount outstanding particularly due to adjustments of loans under Part-II of EFS. The disbursements and the outstanding to the sectors are expected to increase as disbursements against the rollover facility increase. Sports goods showed an increase of 5.4% over the previous quarter. Decline in financing to carpet sector reflects the declining in exports of carpets (**Table 1D**).

Table 1D: Commodity Wise Outstanding Financing

Sector	Dec-10	March-10	March-11	% Change	
		Billion PKR		YoY	QoQ
Textile/Textile Products	130.1	116.0	126.2	8.8	-3.0
Edible Goods	29.8	29.5	27.1	-8.0	-9.0
Leather/Leather Goods	11.6	10.9	11.6	7.0	0.1
Machinery	1.8	1.0	1.4	38.3	-19.7
Metal Products	2.8	2.9	2.1	-28.1	-24.6
Carpets	4.2	2.5	1.7	-31.6	-58.4
Sports Goods	2.6	2.8	2.7	-5.4	2.2
Other Commodities	25.5	27.8	27.3	-1.8	7.2
Total	**208.3**	**193.4**	**200.1**	**3.5**	-3.9

1.7.3. Borrower-wise Distribution

During the 3rd quarter of FY-11, the total number of borrowers under Export Finance Scheme (EFS) stood at 1,705 with an average loan size of Rs.117 million. A nominal decrease of 1% was recorded in total number of borrowers during the quarter under review as compared to previous quarter.

1.7.4. Region-wise Allocation

About 94% of total EFS funds are concentrated in four major cities, i.e., Karachi, Sialkot, Lahore and Faisalabad. But there is an extensive disparity in terms of utilization of EFS funds from one region to another. For instance, Karachi & Sialkot may be equal in terms of total number of borrowers, but the total EFS financing in Karachi stands at 49% *(Rs. 97.77 billion)* of total financing, whereas the same is at 5% *(Rs.9.76 billion)* in Sialkot. Further inconsistent patterns have been witnessed with regard to average loan size and number of borrowers across the regions. For instance, the average loan size at Rawalpindi is Rs.270 million, in Karachi the same is at Rs.183 million, while it is just Rs.18 million per borrower in Sialkot. The smaller loan size in Sialkot is mainly due to the existence of a large number of small business enterprises that are involved in manufacturing and exporting sports goods, surgical instruments and leather products.

1.7.5. Regional Allocation of Borrowers

No change was observed in region-wise allocation of EFS borrowers. According to banks' data for the quarter ended March 31, 2011, up to 88% of borrowers are still from the above mentioned four major cities, where only Karachi & Sialkot have about 62% of total borrowers with both sharing 31% each. There were just 4 borrowers at Rawalpindi as compared to 530 borrowers in Sialkot in the same period.

1.8. Islamic Export Refinance Scheme (IERS)

During the quarter under review, the total number of participating banks was 11 (4 Islamic Banks, 6 conventional banks' Islamic banking operations and 1 foreign Islamic bank). The limits assigned under the scheme were increased by 9% (to Rs. 23.4 billion from Rs. 21.4 billion in Dec-2010), mainly due to shift in maximum limit cap from 10% to 20% for Islamic banking branches of conventional banks. Out of total limits Rs. 12.4 billion has been allocated to Islamic banks and remaining Rs. 11.0 billion to Islamic banking branches of conventional banks. The total IERS financing outstanding at the end of the quarter stood at Rs. 14.66 billion, which increased by 7% from Rs. 13.69 billion in previous quarter.

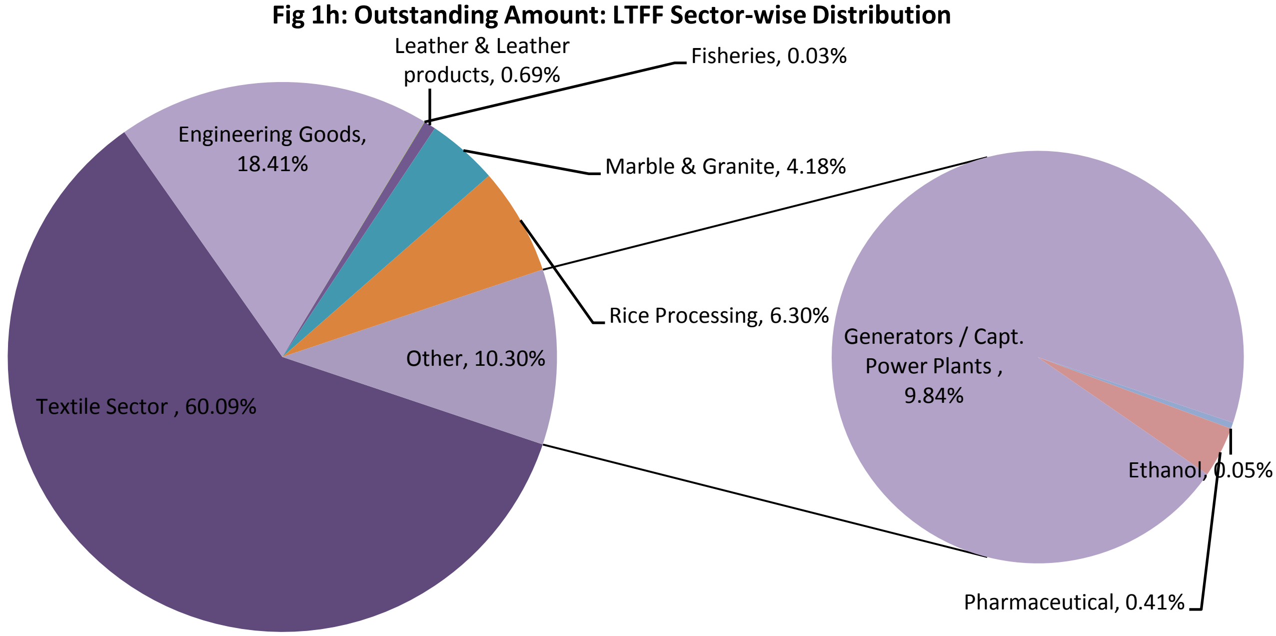
1.9. Long-Term Financing Facilities (LTFF)

During the quarter under review SBP continued to support export oriented projects through provision of long term financing on concessional rates under LTFF Scheme. Mechanism of minimum export sales was rationalized to facilitate the banks/DFIs to finance new borrowers having potential to export on the basis of projected exports. List of sectors eligible under LTFF Scheme was expanded with a view to enhance exports of non-conventional items. To meet growing demand of the stakeholders, SBP increased the maximum borrowing limit of single export oriented unit from Rs. 1.0 billion to Rs. 1.5 billion under the Scheme, so that they are able to reduce their cost of long term borrowing in an environment of increasing mark up rates.

Under the LTFF for plant and machinery, limits of Rs. 19.5 billion have been allocated to banks/DFIs. During the quarter Rs. 1.8 billion were disbursed; the outstanding amount increased by 5.5% to Rs. 23.95 billion in Mar-2011 from Rs. 22.71 billion in Dec-2010.

Under LTFF major portion of financing was extended to textile sector with Rs. 14.4 billion (60.1%), followed by engineering goods, with Rs. 4 billion (18.4%). Within the textile sector major financing was availed by weaving textiles. **Figure 1h** provides a sector wise utilization of funds under the scheme.

Fig 1h: Outstanding Amount: LTFF Sector-wise Distribution



During the quarter, adjustments of Rs. 2.1 billion were made under LTF-EOP (defunct scheme), and the outstanding position of LTF-EOP as on March-11 stood at Rs. 18.6 billion. Thus, the total long term financing outstanding under LTFF and LTF-EOP stood at Rs. 42.5 billion.

Implementation of government initiatives

In pursuance of prime minister's announcement of fiscal relief for Khyber Pakhtunkhwa, FATA and PATA and subsequent budgetary allocation by the ministry of finance, on account of write-off of loans of various districts of war affected areas, State Bank of Pakistan implemented relief package through banks/DFIs vide SMEFD Circular No. 01 dated February 02, 2011. Under this relief package, all loans of the borrowers of Malakand, Swat, Buner and Chitral districts are being written off. Moreover, after release of budgetary allocation by the ministry of finance, SBP also reimbursed 2nd installment of mark-up rate subsidies to banks/DFIs/MFBs against outstanding loans of the borrowers of KPK, FATA and PATA under said relief package.

2.0. Microfinance

Microfinance Banks (MFBs) are entering into larger loan size slowly but persistently. This trend continued during the current quarter as their advances increased by 6.9% despite a marginal decline of 1.0% in the number of borrowers. The decline was seen as the two largest MFBs (KBL and FMFB) had to curtail growth in certain flood affected areas. At the same time, two district MFBs, and Pak Oman MFB continued to reduce their already-thin credit portfolio owing to their internal factors. The negative trends in NPLs were also attributable to the same set of factors – portfolios of KBL & FMFB were hit in flood affected areas whereas two district MFBs and POMFB contributed to NPLs due to their internal weaknesses. On positive side, there are early evidences of recoveries in rescheduled loans in many flood-affected areas. However, the larger impact will be visible after a couple of quarters. After adjusting the outliers (floods and weak MFBs) effects, the portfolio quality remains positive.

Table: 2A				*Amount in Rs. '000'		
Outreach	Mar-10	Dec-10	Mar-11	Growth		
				(YOY) %	(QoQ)%	
Borrowers	646,982	631,238	624,896	-3.4%	-1.0%	↓
Advances *	9,338,299	9,985,488	10,677,662	14.3%	6.9%	↑
NPLs*	214,323	349,502	568,594	165.3%	62.7%	↑
PAR >30 days in%	2.3%	3.5%	5.33%	131.7%	52.3%	↑
Deposits*	6,931,375	10,338,682	8,901,277	28.4%	-13.9%	↓
Assets*	17,653,259	21,437,837	20,667,506	17.1%	-3.6%	↓
Equity*	5,210,237	5,775,137	5,615,400	7.8%	-2.8%	↓

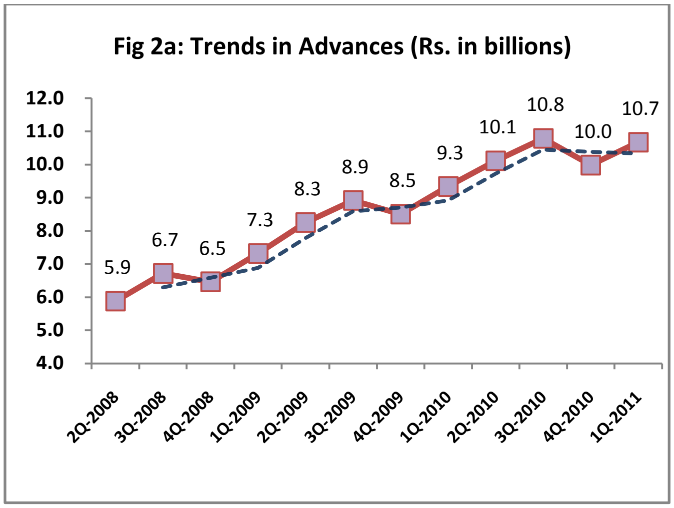
The quarter also saw negative trend in deposits which declined by 13.9%. Few MFBs booked one month term deposit receipts (TDRs) in Dec-2010 which were matured in January 2011. The volatility of deposits has been largely causing the negative fluctuation in the assets base of the MFBs in recent quarters. Equity reduction during the quarter was contributed by almost all MFBs.

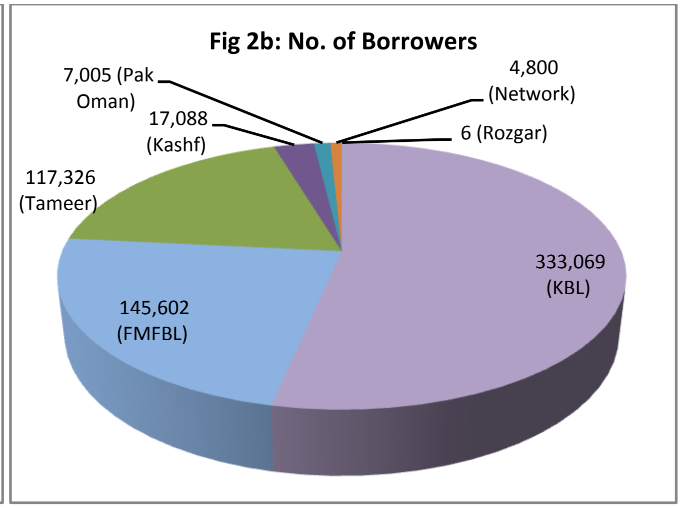
An important development during the quarter was the commencement of NRSP MFB which is expected to significantly enhance the market share of MFBs in forthcoming quarters.

2.1. Advances – Growth, Up-Scaling and Quality

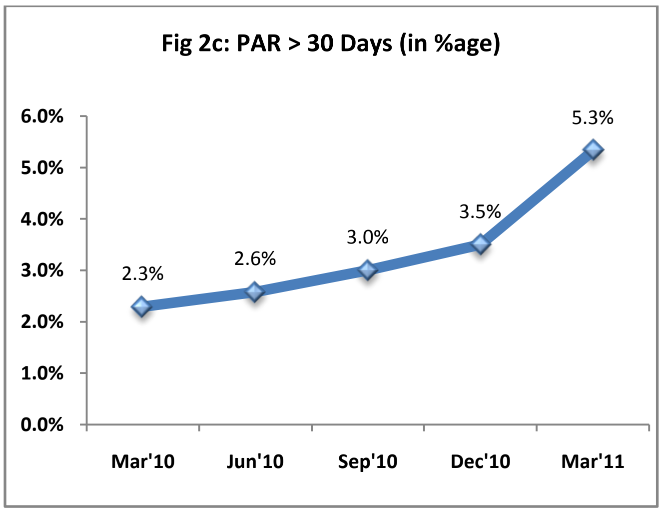
The advances had both conventional and new products. During the quarter under review, the largest players, i.e., KBL and FMFBL disbursed loans for wheat & sugar-cane crops, and livestock. Others focused on new financing products such as warehouse receipt financing, housing finance, motorbike leasing, gold card, etc. The increasing growth in new products is improving the overall portfolio mix which at present include agriculture (32%), livestock (18%), microenterprises (19%), housing (2%), and others (30%)[1]. MFBs have been seeing negative growth in the microenterprises loans because FMFB and KBL had to slow down their lending in war-affected regions (Malakand, Swat, Buner, etc).

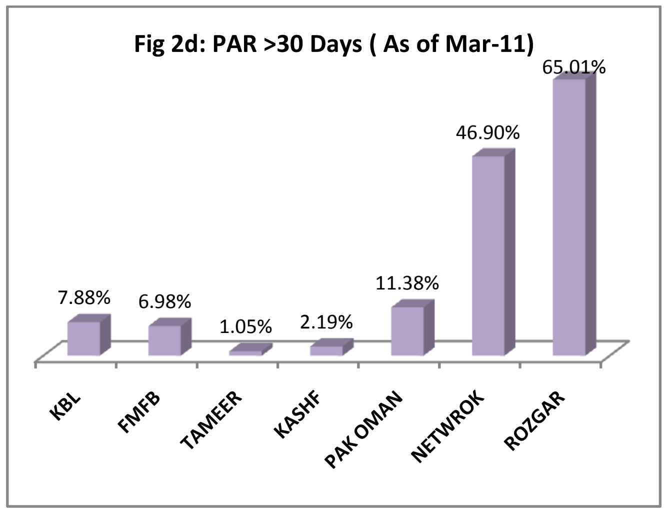
[1] Others category mainly includes secured consumer financing and loans to MFBs own employees.





The outstanding loan size has increased from Rs. 14,433.6 to Rs. 17,087.1 within a year (Q1-10 to Q1-11) which indicates that MFBs are gradually up-scaling.





The Non Performing Loans (NPLs) have sharply increased during the quarter (**Figure 2c**). NPLs increased from 3.5% to 5.3% firstly because the maturity of many bullet loans in flood-affected area fell during the current quarter, secondly three smaller MFBs have experienced double-digit PAR ratio during the quarter (**Figure 2d**), though they share relatively a small portion of overall portfolio. The NPLs may see further increase as some of the bullet loans in flood affected areas will mature in 2nd quarter of 2011.

2.2. Alternate Delivery Channels

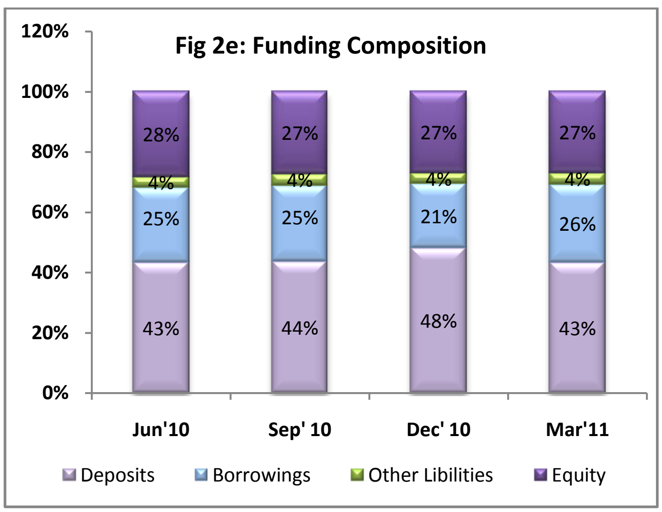
MFBs are becoming forerunner in expanding wide-range of alternative delivery channels. While the number of ‘brick and mortar’ branches is still limited to 287, the MFBs are increasingly aiming to accelerate the flow of financial services through the use of service centers, kiosks at third party locations, branchless banking agents, and ATMs (**Table 2B**).

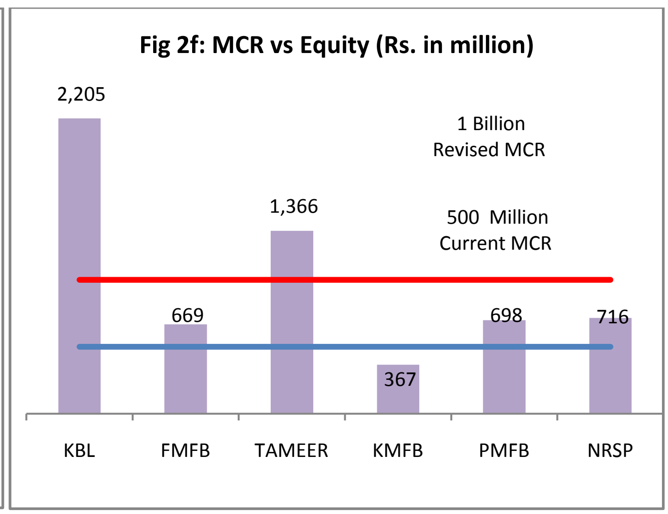
Importantly, microfinance institutions (MFIs) are keen to use branchless banking channels through partnership arrangements. Recently, Assasah (a local MFI) has signed an agreement with Tameer Microfinance Bank for cash management and service delivery facilities for loan disbursement and repayments, making it the first NGO to use mobile financial services for channeling its funds.

Table: 2B	KBL	FMFBL	Tameer	KASHF	NRSP	POMFB	Network	Rozgar	Total
Branches	109	83	41	31	3	14	5	1	287
Service Centers			62			3	7	1	72
BB Agents	-	-	12,700	-	-	-	-	-	12,700
ATMs	-	-	9	-	-	-	-	-	9
Others	-	52*	-	5**	-	-	-	-	57
***Post Office Service Centers, ** Kiosks**									

2.3. Funding Structure

Deposit-Debt mix changed from 48%-21% to 43%-26% in this quarter (**Figure 2e**). Deposits declined due to evaporation of one-month term deposit receipts (TDRs) whereas number of depositors has increased by 11.4%. Total borrowing increased by 18.4% mainly attributable to MCGF facility of Rs. 950 million availed by Tameer MFB.





Deposit-Debt mix will continue to change dynamically in view of expected substantial progress in both funding sources.

Contribution of equity is likely to increase in coming quarters in view of expected injection by few MFBs to meet revised minimum capital requirement (MCR). **Figure 2f** presents current scenario of MFBs (only national level MFBs including NRSP) including equity position with respect to current and revised MCR. At the moment, Kashf does not meet the MCR requirement.

2.4. Assets

The total assets have reduced by 4% during the quarter (**Figure 2g**) as MFBs utilized their cash and investment to redeem the TDRs. While cash & cash equivalent declined, the loan portfolio showed positive growth which ultimately changed the assets mix as depicted in **Figure 2h**. MFBs liquidity position remains quite comfortable as liquid assets (cash & investments) constitute 38% of total assets.

Fig 2g: Growth in Total Assets (Rs. in Billions)

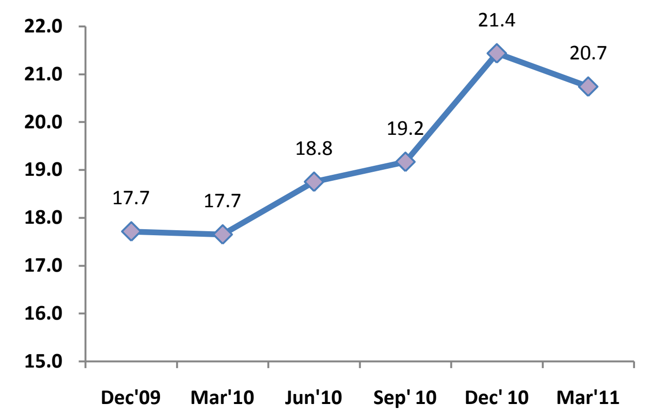


Fig 2h: Assets Composition

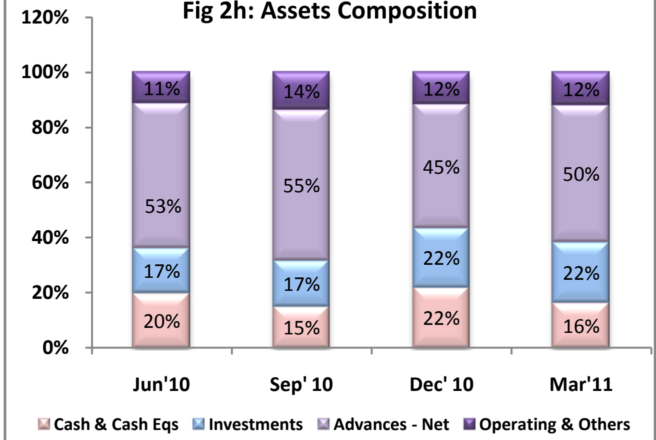


Table 2C shows assets mix of individual MFBs.

Table 2C	KBL	FMFBL	Tameer	KASHF	POMFB	Network	Rozgar
Cash & Cash Eq*	13.0%	10.3%	18.4%	24.8%	67.6%	4.8%	10.2%
Investments	18.6%	44.5%	3.0%	6.5%	7.5%	77.8%	82.0%
Advances	57.1%	39.2%	62.3%	42.3%	11.7%	12.2%	0.2%
Operating & Others	11.3%	6.0%	16.4%	26.4%	13.2%	5.2%	7.6%
***Cash Equivalent includes cash with SBP, NBP and other banks/DFIs/MFBs.**							

3.0. Agricultural Finance

The Agricultural Credit Advisory Committee (ACAC) had set an agricultural credit target of Rs. 270 billion for 2010-11. The target was 8.8 percent higher than the disbursement of Rs. 248 billion in 2009-10. Out of the total target, Rs 181.3 billion were allocated to commercial banks, Rs. 81.8 billion to ZTBL and Rs. 6.9 billion to Punjab Provincial Cooperative Bank Limited.

3.1. Agricultural Credit Disbursement

During July 2010-March 2011 banks disbursed an amount of Rs. 168.7 billion or 62.48% of the annual target of Rs. 270 billion compared with disbursement of Rs. 166.3 billion or 64.0 % of the target of Rs. 260 billion during corresponding period last year. This trend is an indication that the possibility of meeting annual target is very low. Annual growth remained almost negligible with a rise of Rs. 2.4 billion or around 1.4% compared with corresponding period last year.

Quarter- wise disbursement reveals that banks disbursed Rs. 67.1 billion during Jan-Mar, 2011 compared with disbursement of Rs. 60.1 billion in Oct-Dec, 2010 (preceding quarter) and Rs. 60.1 billion in the same quarter last year. Detail of indicative agricultural credit targets of Rs. 270 billion for FY11 and actual disbursements by banks up to Mar-2011 and in the corresponding period last year are given in **Table 3A**.

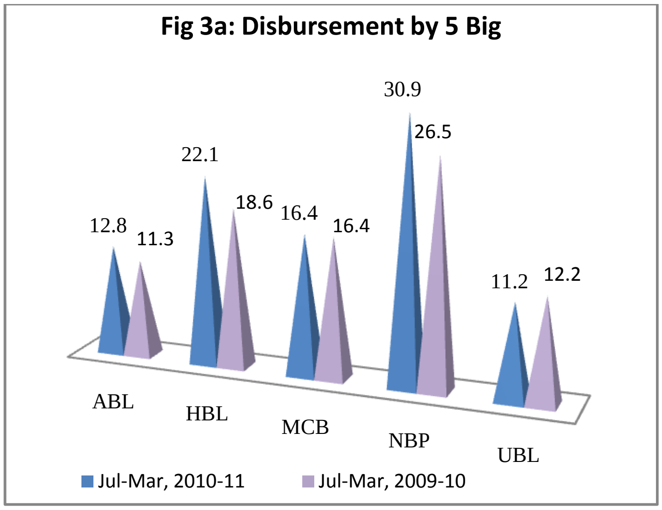
Table 3A: Agricultural Credit Targets and Disbursement (Rs. Billions)

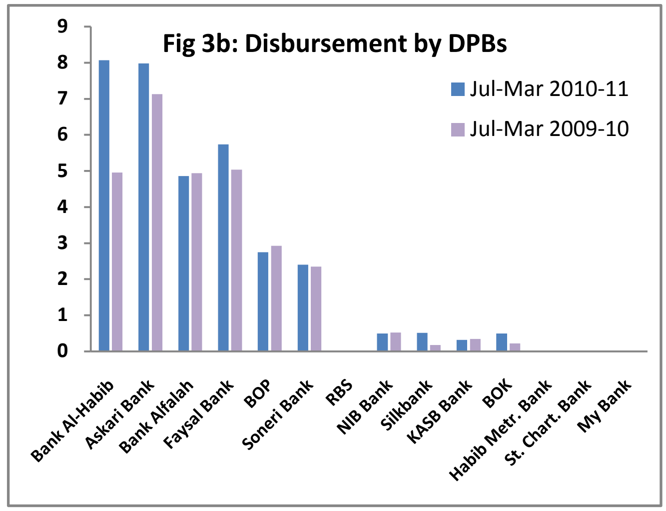
Banks	**Target 10-11**	**Disbursement**				**Target 09-10**	**Disbursement**			
		Jul-Sep 2010	Oct-Dec 2010	Jan-Mar 2011	Jul-Mar 2010-11		Jul-Sep 2009	Oct-Dec 2009	Jan-Mar 2010	Jul-Mar 2009-10
5 Big*	132.45	25.9	29.1	38.2	93.3	124.0	25.8	29.6	29.8	85.2
ZTBL	81.8	5.3	15.7	16.4	37.4	80.0	9.9	20.5	18.5	49.0
DPBs	48.9	9.4	13.3	11.0	33.7	50.0	7.8	10.4	10.5	28.6
PPCBL	6.85	0.9	2.0	1.5	4.4	6.0	0.6	1.7	1.3	3.5
Total	**270.0**	**41.5**	**60.1**	**67.1**	**168.7**	**260.0**	**44.1**	**62.2**	**60.1**	**166.3**

* ABL, HBL, MCB, NBP and UBL

Bank-wise break up of agri. credit disbursements reveals that during July-March 2010-11 five major banks, as a group disbursed Rs. 93.3 billion or 70.4% of the whole year targets; ZTBL disbursed Rs. 37.4 billion or 45.7% of the targets, Domestic Private Banks (DPBs) disbursed Rs. 33.7 billion or 68.8% of the targets and PPCBL disbursed Rs. 4.4 billion or 64.1% of the targets. While performance of 5 major commercial banks, PPCBL and DPBs showed some improvement compared with last year's disbursements, the performance of ZTBL remained sluggish.

The cumulative position of agri. credit disbursements by five major banks for the period July-March, 2010-11 and, 2009-10 has been illustrated in **Figure 3a.**





Comparative analysis/ position of agri. credit disbursement by DPBs during Jul-Mar, 2009-10 and Jul-Mar-2010-11 is illustrated in **Figure 3b**.

Table 3B: Disbursement to Farm & Non-Farm Sectors (Rs. Billions)

Sector		2010-11				2009-10			
		Jul-Sep 2010	Oct-Dec 2010	Jan-Mar 2011	Jul-Mar 10-11	Jul-Sep 2009	Oct-Dec 2009	Jan-Mar 2010	Jul-Mar 09-10
A	**Farm Credit**	**26.0**	**39.0**	**45.5**	**110.5**	**29.7**	**44.1**	**41.0**	**114.9**
1	**Subsistence Holding**	**15.0**	**23.1**	**27.9**	**66.0**	**18.5**	**26.4**	**24.0**	**68.9**
	Production	14.2	21.9	27.0	63.1	16.0	23.5	21.2	60.7
	Development	0.8	1.2	0.8	2.8	2.5	2.9	2.8	8.2
2	**Economic Holding**	**7.0**	**9.9**	**11.8**	**28.7**	**6.9**	**11.1**	**10.9**	**28.9**
	Production	6.8	9.6	11.5	27.0	6.8	9.8	10.3	26.9
	Development	0.2	0.3	0.2	0.7	0.1	1.3	0.6	2.0
3	**Above Economic Holding**	**4.0**	**6.0**	**5.8**	**15.8**	**4.3**	**6.6**	**6.1**	**17.1**
	Production	3.8	5.6	5.7	15.1	4.1	6.1	5.8	16.1
	Development	0.2	0.4	0.1	0.7	0.2	0.5	0.3	1.0
B	**Non-Farm Credit**	**15.5**	**21.1**	**21.6**	**58.2**	**14.4**	**18.1**	**19.0**	**51.5**
1	Small Farms	3.4	4.4	4.9	12.7	2.5	4.6	4.0	11.1
2	Large Farms	12.1	16.7	16.8	45.6	11.9	13.5	15.0	40.4
Total (A+B)		**41.5**	**60.1**	**67.1**	**168.7**	**44.1**	**62.2**	**60.0**	**166.33**

Sector-wise classification indicates that disbursement to farm sector declined from Rs.144.9 billion during Jul-Mar 2009-10 to Rs. 110.5 billion during Jul-Mar 2010-11. The decline is mainly attributed to: (a) improved farm income on the back of higher commodity prices; and (b) cautious lending by the banks. Anecdotal evidence also suggests that credit sharing arrangements between sugarcane farmers and sugar mills were also responsible for sluggishness in credit demand by farm sub-sector during the current fiscal year. The impact of decline in disbursement in the farm sector was, however, more than offset by a remarkable 13.0 percent increase in disbursement in non-farm sector during this period.

Consequently, the share of non-farm sector has increased from 31.0% to 34.5%. There has been a continuous increasing trend in the share of non-farm sector over the last few years mainly due to SBP's initiatives, i.e. issuance of guidelines for non- farm sector in the areas of livestock, fisheries and poultry financing, rising domestic demand for fish & poultry, increase in export of livestock, etc. Quarter-wise disbursement to farm and non-farm sectors is given in **Table 3B**, while their percentage share in agricultural credit disbursement is given in **Figure 3c**.

3.2. Region-wise Disbursement

Table 3C: Region-wise Indicative Agri. Credit Targets and Disbursement (Rs. Billions)

Regions	Target 2010-11	Disbursement				Target 2009-10	Disbursement			
		Jul-Sep 10	Oct-Dec 10	Jan-Mar 11	Jul-Mar 10-11		Jul-Sep 09	Oct-Dec 09	Jan-Mar 10	Jul-Mar 09-10
Punjab	210.6	36.0	53.0	57.9	146.9	202.8	36.6	54.4	51.5	142.4
Sindh	37.8	4.2	5.3	6.7	16.2	36.4	5.8	6.0	6.4	18.3
KPK	16.2	1.1	1.5	2.2	4.8	15.6	1.3	1.5	1.9	4.6
Baluchistan	4.1	0.1	0.0	0.1	0.2	3.9	0.1	0.1	0.1	0.4
AJK & GB	1.4	0.1	0.3	0.2	0.6	1.3	0.2	0.2	0.2	0.6
Total	**270.0**	**41.5**	**60.1**	**67.1**	**168.7**	**260.0**	**44.1**	**62.2**	**60.1**	**166.3**

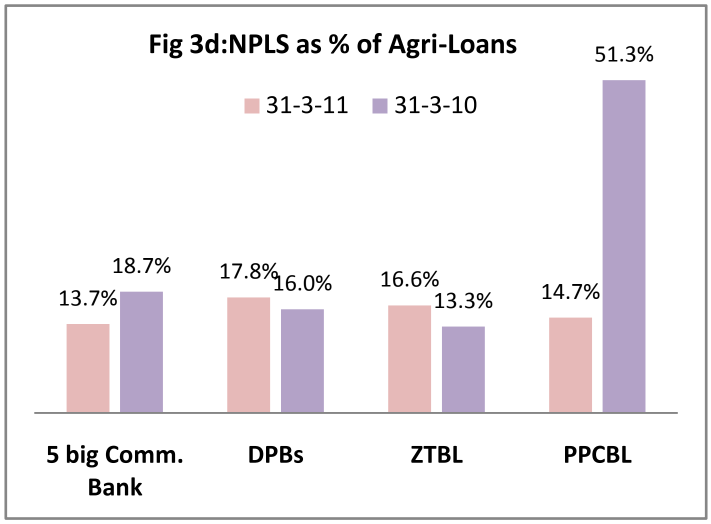
Region-wise agri-credit disbursement position during Jul- Mar, 2010-11 shows that out of total disbursement of Rs. 168.7 billion, Rs. 147.0 billion or 87.1% were disbursed in Punjab, Rs. 16.2 billion (or 9.6%) in Sindh, Rs. 4.76 billion (or 2.8%) in Khyber Pakhtunkhwa, Rs. 0.15 billion (or 0.1%) in Baluchistan, Rs. 0.42 billion or (0.3%) in AJK and 0.2 billion (or 0.1%) in Gilgit-Baltistan (GB). Only Punjab was able to resister an improvement in its share in agri-credit disbursement during the period under review.

This analysis reveals a marginal improvement in agri-credit disbursement in Punjab, Khyber Pakhtunkhwa and a considerable growth in AJK, whereas, Sindh and Baluchistan continued the declining trend. Disbursement in GB has decelerated compared to last year. The share of other provinces and regions apart from Punjab is negligible in agri-credit due to weak demand, law and order situation, documentation issues and shyness of banks to expand their agri-credit exposure. Details of province-wise disbursements, vis-à-vis targets achieved are given in **Table 3C**.

3.3. Agri. Non-Performing Loans

Non-performing loans in agri. financing stood at Rs. 28.93 billion (or 16.8%) of the outstanding loans as on Mar-2011 compared with Rs. 28.28 billion (or 16.9%) of the outstanding loans as on Mar-2010. Bank wise detail of NPLs is given in **Table 3D. Figure 3d** shows NPLs' position of banks as a percentage of their outstanding loans during Q3 of 2010 and 2011. While an improvement is evident in NPLs of five big banks and PPCBL in March 2011, a substantial deterioration in the case of ZTBL led to rise in NPLs in agri-sector.

Table 3D: Agri. Non-Performing Loans (Rs Billions)				
	March 2011		March 2010	
Banks	NPLs	loans	NPLs	Loans
5 Big Banks	7.35	53.54	9.28	49.76
DPBs	3.88	21.87	3.59	22.45
ZTBL	14.93	89.78	11.81	88.56
PPCBL	2.76	6.79	3.59	7.00
Total	**28.93**	**171.99**	**28.28**	**167.78**



3.4. Number of Agri. Loan Borrowers

The number of agri. loan borrowers was 1.779 million as on March, 2011 against 1.832 million as on March, 2010 showing a decline of around 3%. Bank-wise position of outstanding number of borrowers reveals that decrease in number of borrowers was witnessed especially in ZTBL, DPBs, marginally in PPCBL and 5 major banks. High mark up rate, increasing NPLs and defaults in repayment due to a variety of reasons like recent floods, law & order situation, good prices of wheat and cotton in non-flood affected areas improving cash flow of farmers resulted in decline in outstanding number of borrowers over the period shown in **Table 3E.**

Table 3E:Number of Outstanding Borrowers				
Banks	**As on March, 2011**		**As on March, 2010**	
	Borrowers	% Share	Borrowers	% Share
5 Big Banks	428,438	24.1	420,759	23.0
ZTBL	1,127,768	63.4	1,169,282	63.8
DPBs	36,639	2.1	55,549	3.0
PPCBL	185,407	10.4	186,732	10.2
Total	**1,778,252**	**100.0**	**1,832,322**	**100.0**

4.0. Housing Finance

In Pakistan, rapid urbanization is a serious challenge putting immense pressure on already insufficient residential facilities in the cities. Moreover, limited availability of housing finance facilities add to the woes of housing sector. Studies indicate that lack of finance from a formal source is primarily a supply-side problem. Most of the housing finance is arranged through personal resources. The formal financial sector caters only to 1 to 2 percent of all housing transactions in the country, whereas informal lending caters up to 10-12% of such transactions. Presently, the formal financial sector provides housing support through two major sources namely the government owned House Building Finance Corporation (HBFC) and private commercial banks.

The major reason of limited participation of financial sector is low confidence in the real estate related market. Financial weaknesses and absence of clear, uniform and fair business practices have affected its credibility contributing to the reluctance of financial institutions in providing development and construction finance. There is also a strong need to strengthen the property titling and land administrative procedures including improvements of the legal provisions, standardization of processes, and computerization of all relevant revenue records. These steps will enhance the investment in housing and financing by the formal sector. Weakness in the existing legal framework also impedes the financing opportunities of the formal financial sector. Though the Financial Institution Recovery Ordinance, 2001 empowers the financial institutions in case of default to foreclose a mortgage property without recourse to the court of law, lack of full implementation of the recovery law in its letter and spirit dilutes its effectiveness in protection of rights of the respective parties, i.e., the financial institutions, mortgagors, landlords and tenants, thus needing a major improvement.

Although the regulatory framework for land registration and transfer regime exists in Pakistan, the process by which land is acquired and registered is cumbersome at times, because of number of institutions and registration procedures required to execute property transactions. Land records are manually maintained leading to errors and omissions and resultantly they have modest commercial value for the mortgagee financial institutions especially in rural and some urban areas. The lack of efficient and reliable system of ascertaining the bona-fide of property titles has forced banks to limit the access of housing finance to a certain number of urban localities within the urban centers.

National and local master plans for town planning and housing facilities are either inadequate or poorly enforced, which lead to inefficient allocation of land and uncontrolled urban development. Lack of transparency and accountability in the planning process also give opportunities to land grabbers/mafias to have valuable inside information as to future infrastructure developments or to be able to influence such plans so that value of its land increases. Over-restrictive building codes and laws on subdivision limit the efficient use of urban land and increase the price to genuine consumers, especially in zones having relatively higher prices of lands. Moreover, the large scale projects often get delayed due to (a) failure of utility companies in connecting new housing developments in time; (b) absence of rules to enforce timely hand-over the property to investor, and (c) this tactic is generally used with upward revisions in various charges (documentations, lease, utility etc.) to discourage the investor to get possession.

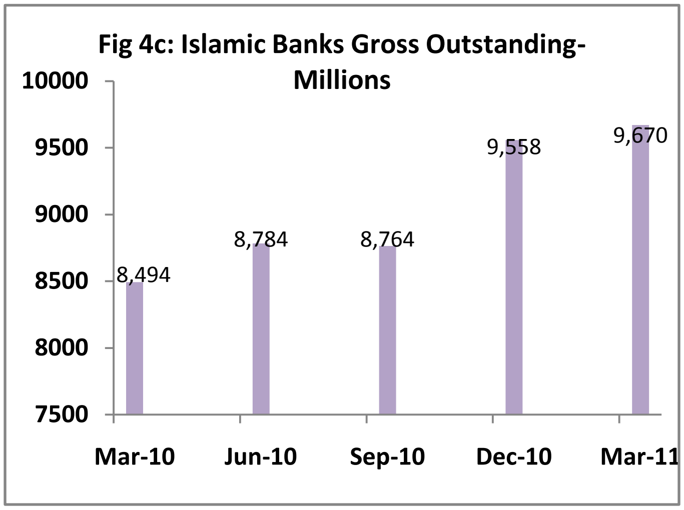
The "property valuers" have professional conduct requirements that were established by SBP and the Pakistan Banks' Association (PBA), whereas majority of real estate builders and developers are working as sole proprietorships or partnerships with limited capital and informal corporate governance structures. Absence of sound governance structure within the housing developer industry creates lack of good practices, illegal construction, unreliable building permits, and legally unprotected advance purchase of units that are required to be built in future. The unstructured and unsupervised nature of business of real estate brokers/ agencies, which could serve as natural arrangers for the provision of financial services, is also a significant constraint to the provision of housing and housing finance.

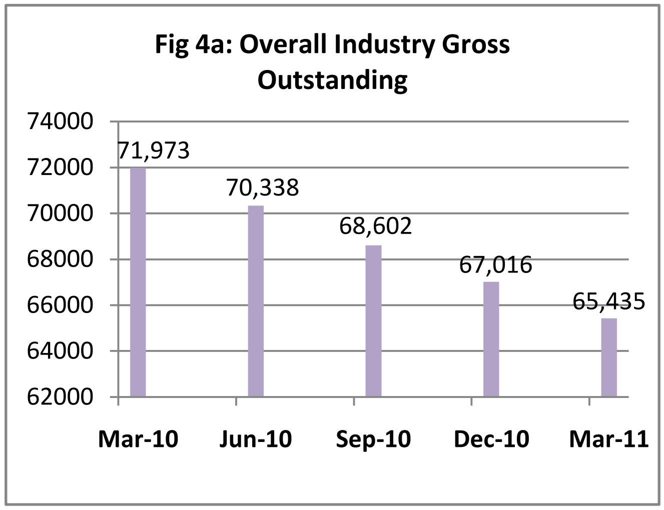
Consequently, it is difficult for financial institutions to verify the character, capital, and capacity of potential clients. Risk assessment and portfolio valuation is also fragile, which is another factor for the lenders' extreme caution for transaction initiated by these venture. As a result, financial institutions are reluctant to enter this market, which in turn causes scarcity of finance and constraints in the supply of housing. In the absence of the formal arrangements between the housing developers/real estate agents etc and financial institutions, the protection of individual purchasers remains limited as the market is dominated by cash transactions with limited availability of systematic information in a transparent manner. Without using a strong regulatory authority to enforce corporate governance and allied standards for this stratum of business entrepreneurship, the quality of availability of housing facilities across population spectrum will not improve.

At present, 27 commercial banks, House Building Finance Corporation (HBFC), one DFI and two microfinance banks are catering to housing finance needs in the country. HBFC is the only specialized housing bank in the country, which has been providing housing finance to public since 1952. Commercial banks entered the mortgage business during 2003 contributing very small share in the housing finance system. Although HBFC's share in the total housing finance has reduced, it is still the only institution that continues to cater to the lower-middle and low-income groups and enjoys the largest customer base. Recently microfinance banks have also started serving the lower-middle income groups.

After demonstrating a promising growth trend till 2008, the housing finance sector has recently been showing a declining trend. The total outstanding reported by banks and DFIs as on Mar, 2011 was Rs. 65.43 billion as compared to Rs. 71.97 billion as on Mar, 2010 (a decline of 9.1%) and Rs. 67 billion at the end of Dec, 2010. The total number of outstanding borrowers has also decreased from 110,512 to 94,497 since Mar, 2010; showing a fall of 14.5%.

Approximately 1,403 new borrowers availed house finance of Rs. 4.31 billion during Jan-Mar, 11. HBFC accounted for 25.6% of these new borrowers and contributed 10.5% of the new disbursements equivalent to Rs. 452 million, indicating an average loan size of about Rs.1.25 million. Financing for outright purchase continued to dominate financing for construction and renovation comprising almost 57% share in gross outstanding portfolio. Outstanding portfolio for construction and renovation was 34% and 9% respectively.





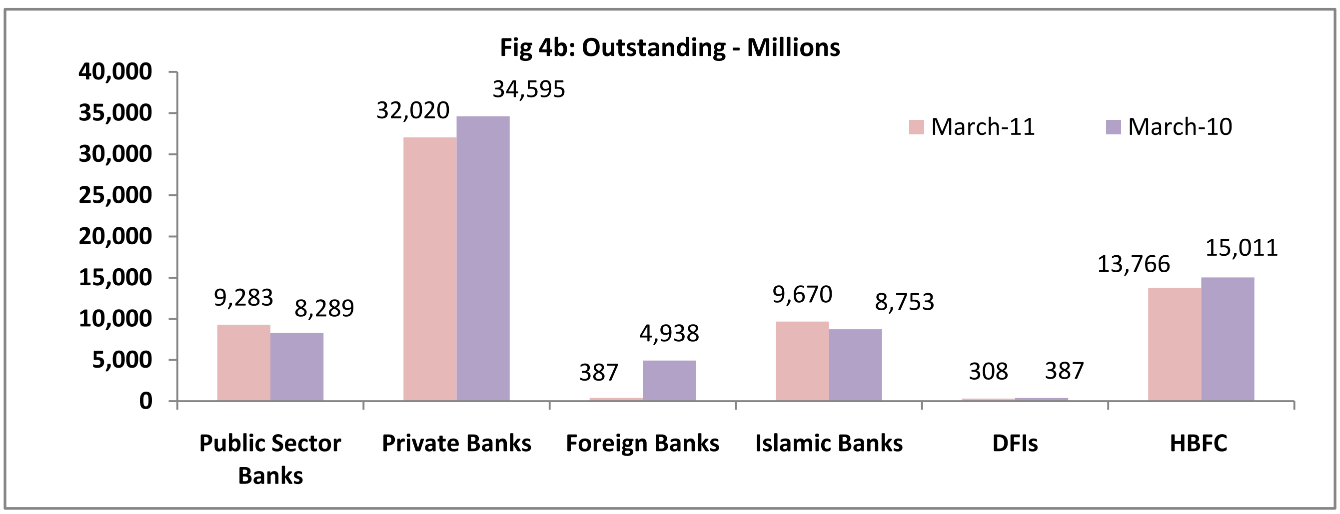
Non-performing loans have increased to Rs. 18.93 billion at the end of Mar-2011 from Rs. 16.83 billion as on end Mar-2010 and Rs. 18.5 billion as on Dec-2010. While rise in NPLs is not unique to housing finance, it is substantially lower than the increase in NPLs in other sectors during the quarter under review.

4.1. Major Trends

4.1.1. Gross Outstanding

The total outstanding housing finance as on Mar-2011 of all banks and DFIs stood at Rs. 65.43 billion, compared to Rs. 67 billion as on Dec-2010, showing a decrease of Rs. 1.57 (2.3%).(**Figure 4b)**

Furthermore, compared to quarter ending Mar-10, outstanding of all commercial banks/DFIs decreased by 9.1



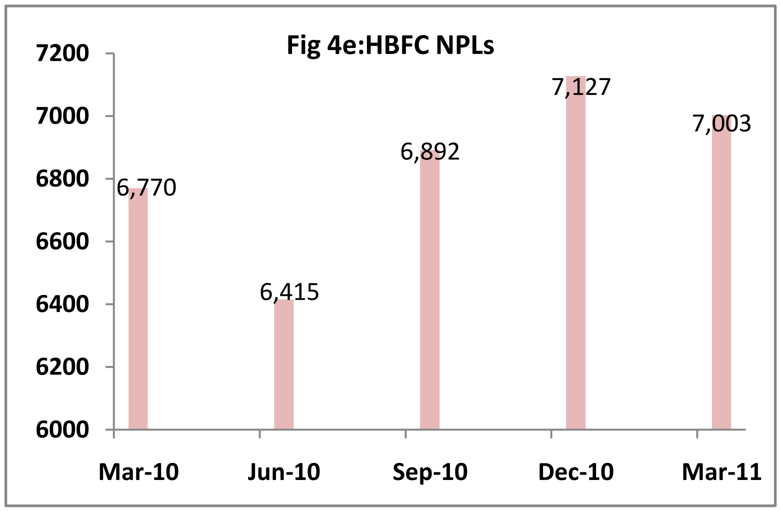
percent. This decline is owed to fall in outstanding housing finance by private banks, foreign banks and HBFC as both public sector banks and the Islamic banks registered an increase in their outstanding amount under housing finance. This divergence in trend is probably a reflection of mergers of some private foreign as well as Islamic banks, which may impede their housing finance related operations during the current fiscal year.

4.1.2. Non Performing Loans

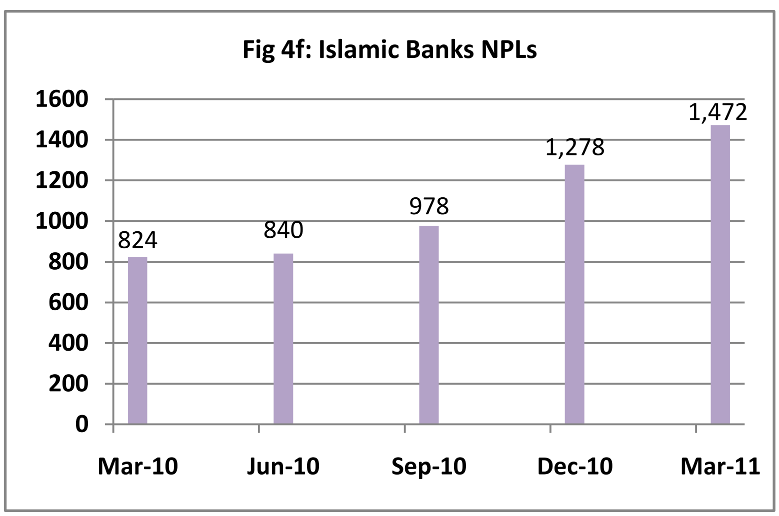
NPLs have increased from Rs. 16.83 billion (Mar-2010) to Rs. 18.93 billion (Mar-2011); a 12.5% increase during the year. The stock of NPLs as on Dec-2010 was Rs. 18.54 billion, showing an increase of 2.1 % during the quarter Jan-Mar, 2011 as shown in **figure 4d**.

NPLs as a proportion of total outstanding have witnessed an increasing trend over the last twelve months. This rise in NPLs is primarily due to economic slowdown and absence of buyers in real estate market. As a result, prices of most of the properties remained either unchanged or declined in recent years across the country. Contrary to overall NPLs of housing industry, HBFC's NPLs showed a marginal decline in Jan-Mar 2011 quarter, relative the preceding quarter (Figure **4e)**. It is probably a reflection of success of HBFC aggressive drive for recovery and announcing the names of defaulters in recent months. This is a welcome development and all efforts should be made to make further improvement.

Excluding HBFC, NPLs for all banks and other DFIs have increased by 18.6% over the year from Rs. 10.06 billion to Rs. 11.92 billion. The percentage share of NPLs that all banks and other DFIs (excluding HBFC) constitute is 23.1% of their total outstanding portfolio, compared to a 17.7% as on Mar-2010.



Among banks, non-performing finances (NPFs) of Islamic banks witnessed the sharpest increase of almost 78.6% during the year, from Rs. 824 million to Rs. 1.47 billion. Their NPFs constitute 7.8% of total outstanding, which was only 4.9% on Mar-2010. NPLs of the public sector banks have increased from Rs. 1.25 billion to Rs. 2.12 billion (an increase of 69.6%) which are 11.2% of total outstanding. Private Banks' NPLs have increased by 16.1%, from Rs. 6.98 billion to Rs. 8.10 billion which is 42.8% of their total outstanding as against 41.5% on Mar-2010.

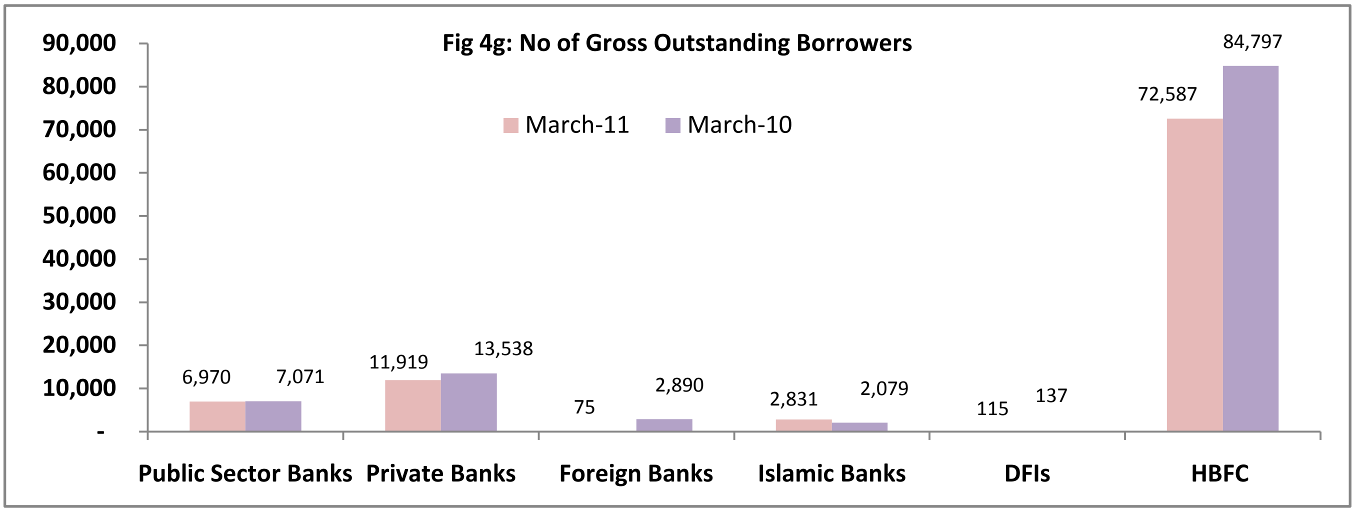


NPLs of foreign banks as a percentage of their outstanding portfolio increased significantly from 18.6% at the end of last year to 29.8%. However in absolute terms NPLs have increased only marginally as their portfolio has been significantly reduced due to take over of RBS portfolio by Faysal Bank.

Non-Performing finances (NPFs) for Islamic banking industry (IBs & IBDs) was reported Rs.2.26 billion at the end of Mar-2011, which was Rs. 2.05 billion at the end of last quarter (Sep-Dec, 2010) showing an increase of 9.8%.

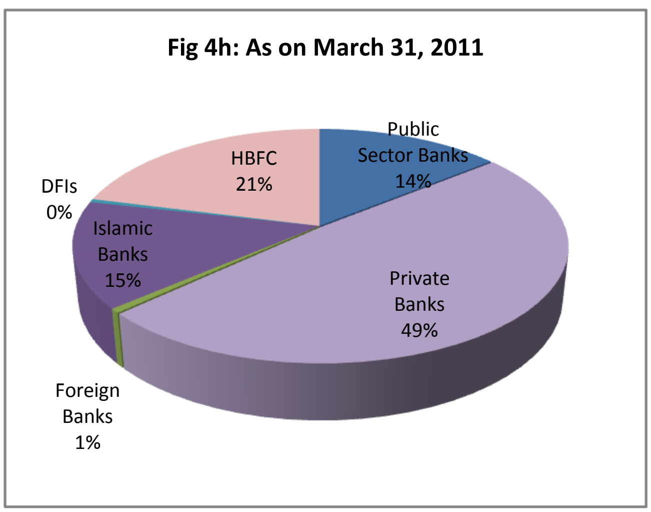
4.1.3. Number of Borrowers

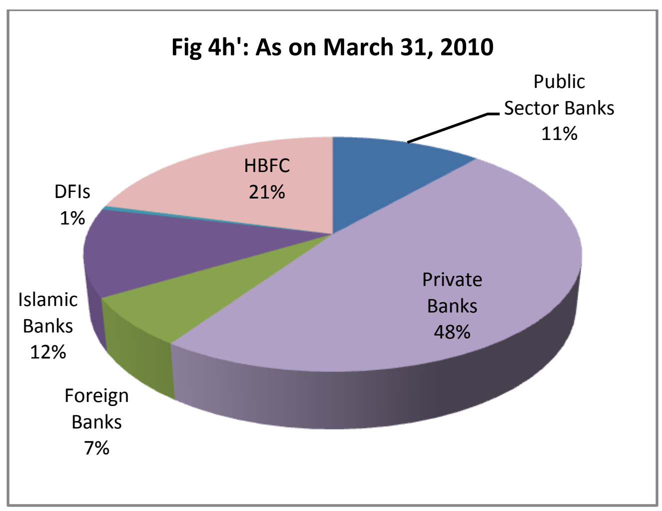
Total number of outstanding borrowers has decreased from 110,512 to 94,497 since March 31, 2010; a decline of 14.49%. As shown in **Figure 4g**, there is a decrease in number of borrowers in each category except Islamic



banks, where numbers increased from 2,079 to 2,831.

In terms of numbers, approximately 57.9% of total borrowers of housing finance borrowers have been classified as non-performing. However, this is primarily due to HBFC's number (51,119) of non-active borrowers, classified as non-performing, which comes to 70.5% of its total borrowers.





Thus, excluding HBFC in such an analysis will be important as it caters to 79% of the total borrowers in housing finance sector which accounts for only 21% of total outstanding portfolio. Thus, by excluding HBFC, 17% of total borrowers of housing loans have been classified as non-performing.

Total number of customers served by Islamic Banking Industry increased from 4,004 to 4,065 (an increase of 1.52%) since Dec 2010.

4.1.4. Share Of Banks

Fig 4i: Share of Conventional Banking, Islamic Banking

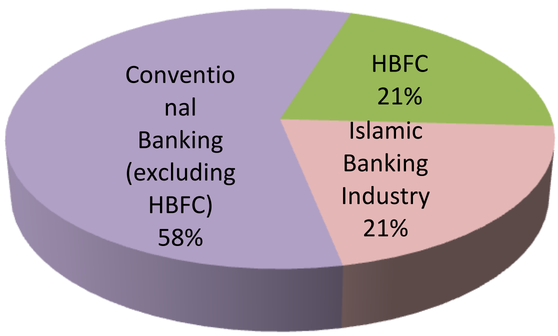


Fig 4i': Islamic Banking Industry vs Conventional

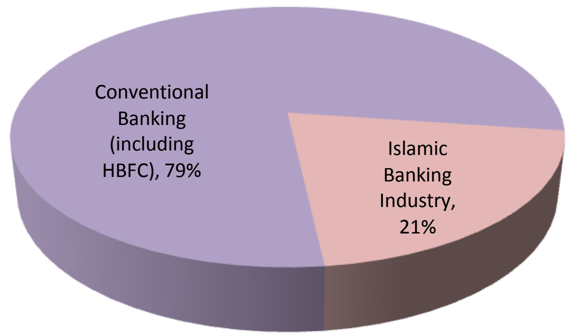


Fig 4j: Islamic Banks Vs Islamic Divisions as on March 31, 2011

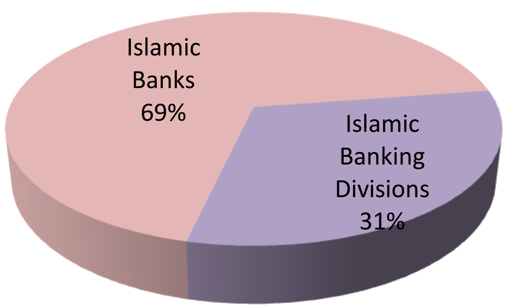
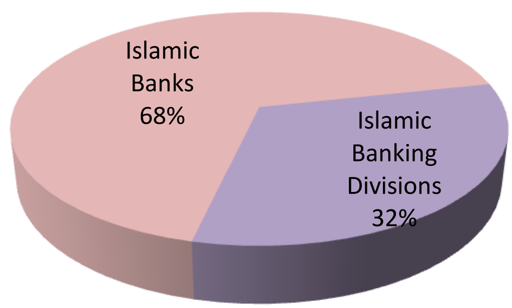


Fig 4j': Islamic Banks Vs Islamic Divisions Dec 31, 2010



The overall market share (based on gross outstanding) of commercial banks (excluding DFIs) remained unchanged from the end of last year, 79%. Within commercial banks, the share of private banks in the total outstanding increased marginally from 48% to 49% and the share of foreign banks decreased from 7% to 1% due to take over of RBS portfolio by Faysal Bank (**Figure 4i & 4i'**). The share of public sector banks and Islamic Banks in the total outstanding increased from 12% to 14% and 12% to 15%. Share of HBFC remained the same since the end of last year 21%.

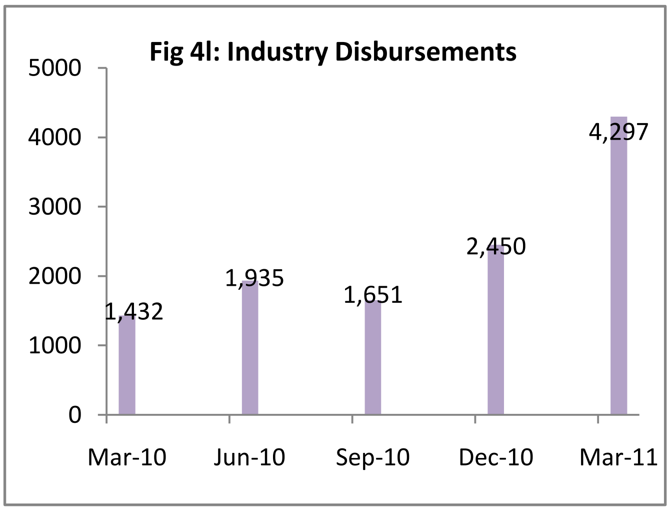
The share of conventional banking (excluding HBFC), Islamic banking industry and HBFC in the total outstanding was 58%, 21% and 21% respectively on Mar-2011 (**Figure 4j & 4j'**.1). IBDs (13 windows) and Islamic banks (05 banks) have 69% and 31% share in housing finance portfolio of Islamic Banking Industry, which shows that conventional banks also consider the Islamic mode of financing an important part of their business strategy. One reason of increasing Islamic banks outstanding portfolio is the purchase of Citibank's portfolio of Rs. 888 million by BankIslami in the quarter ending Dec-2010.

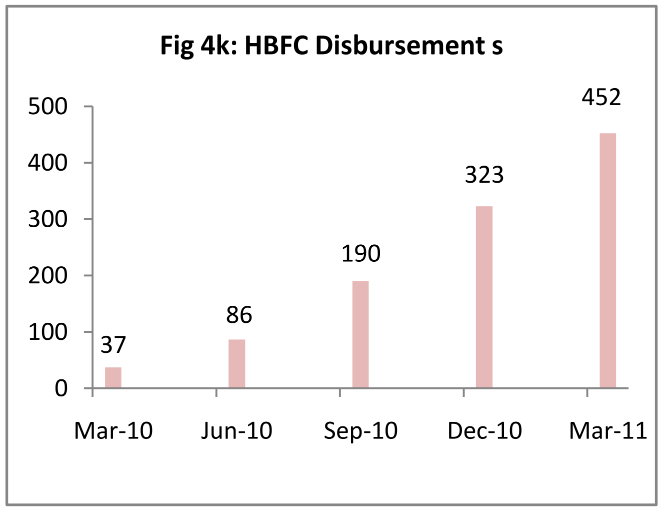
4.2. Disbursements

Fresh disbursements of Rs. 4.31 billion were made to 1,403 borrowers during the quarter ending Mar-2011 (**Table 4A**) Private banks extended new disbursements with Rs. 3.44 billion followed by Islamic banks with Rs. 329 million, public sector banks with Rs. 72 million and foreign banks with Rs. 0.31 million. HBFC's fresh disbursements for the quarter were reported to be Rs. 452 million.

Table 4A: New Disbursements (Rs. Millions)

	Dec-10		Mar-11	
	Amount	Borrowers	Amount	Borrowers
Public Sector Banks	68	23	72	20
Private Banks	749	289	3442	938
Foreign Banks	32	11	0.31	1
Islamic Banks	1,278	466	329	78
All Banks	2,127	789	3863	1044
DFIs	-	-	-	-
HBFC	323	501	452	359
Total	**2,450**	**1,290**	**4,315**	**1,403**
Islamic Industry	1,452	505	846	158



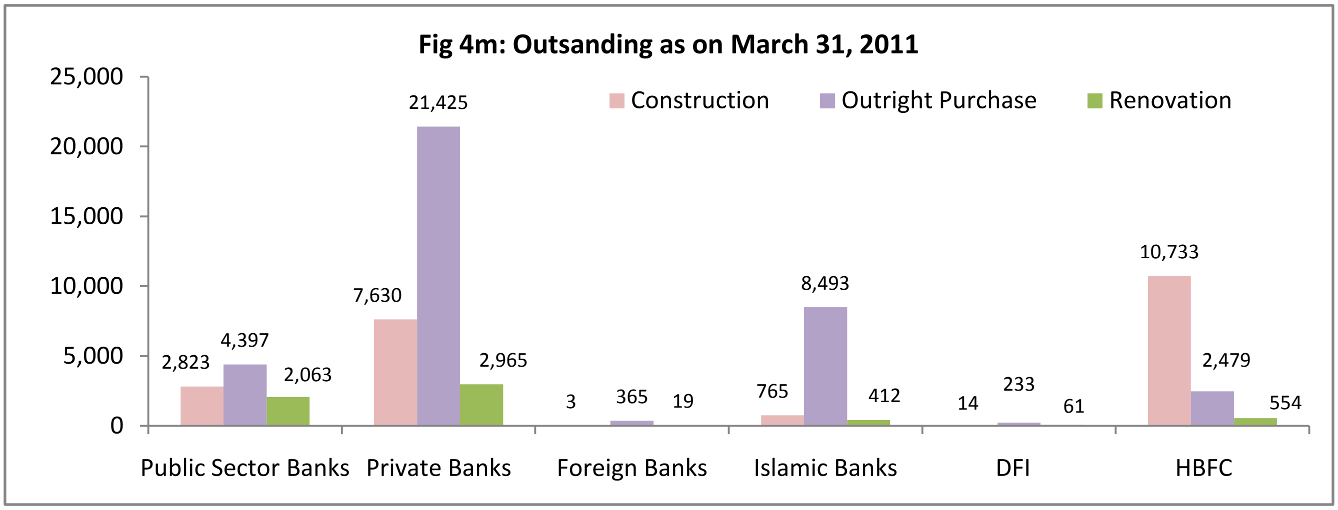


Among commercial banks, the number of new borrowers totaled 1,044, with private banks serving 938 borrowers and Islamic banks 78 borrowers. HBFC extended loans to 359 new borrowers during the reporting quarter.

Fresh disbursements for Islamic banking industry were Rs. 846 million to 158 new borrowers during the quarter ending Mar-2011 (**Table 4A**). This included new disbursements of Rs. 517 million to 80 customers by IBDs of conventional banks.

4.3. Sectoral Share

The biggest share of housing finance continued to be attracted towards outright purchase (**Figure 4m**). It is important to note that all institutions extended substantially higher loans under this category except HBFC, mainly due to convenience of execution, low cost of evaluation and no monitoring requirement. In contrast, borrowers have to make repeated contacts with the lending institution for the release of installment of loan and also required to be evaluated and monitored on periodic basis.



The outstanding for outright purchase stood at Rs. 37.39 billion as on March 31, 2011; a 57% share in total outstanding of Rs. 65.43 billion. This is followed by the construction category where outstanding reported at quarter-end stood at Rs. 21.96 billion and that of renovation stood at Rs. 6.07 billion. Active portfolio shows that private banks have taken a lead in financing for all three sectors; construction 43%, outright purchase 54% and renovation 39%.

4.4. Housing Finance Business of Micro Finance Banks

Gross Outstanding

The total outstanding housing finance as on March 31, 2011 of Micro Finance Banks (MFBs) stood at Rs. 161.60 millions, which was Rs. 152.14 millions at the end of Dec 31, 2010, showing an increase of 6.22%, over the last quarter.

Number of Borrowers

Total number of outstanding borrowers has increased from 2,121 to 2,222 since Dec 31, 2010; an increase of 4.76%.

Non-Performing Loans

NPLs for Micro Finance Banks have declined from Rs. 1.46 million (Dec-2010) to Rs. 1.25 million (Mar-2011); a 14.4% decrease over the last quarter. NPLs of MFBs arising out of housing finance business are around 1.0% of their outstanding housing finance portfolio.

4.5. Analysis of Loan Variables

An analysis of Loan variables across all banking sectors is given as under.

Weighted average interest rate

The overall weighted average interest rate was 17.2% at the end of the reviewed quarter. Highest weighted average profit rate reported by HBFC was 17.5%, followed by Islamic banks 17.3%, private banks'-17.1%, public sector banks 16.8% and foreign banks average came to the lowest 14.1%.

Average maturity periods

Average maturity period of outstanding loans as on Mar-2011 came to 13.4 years, which is higher as compared to quarter ending Mar-2010 when it was 12.5 years. HBFC's average maturity period is reported to be 13.5 years, while that of Islamic banks is 12.2 years. Among commercial banks, foreign sector banks have extended housing loans for an average tenure of 20 years followed by private sector banks with 13 years and public sector banks with 13.2 years.

Loan to Value ratio

The percentage of financing (Loan to Value ratio) extended by banks and DFIs decreased during last year (Mar-2010) from 54.9% to 48.5% (Mar-2011). Average LTVs of commercial banks have decreased from 55.4% to 48.5%. The average LTV for HBFC has decreased from 65.0% to 44.7% during the last year, which is a significant change.

Average time for loan processing

The reported average time for loan processing is approximately-29 days for all banks and DFIs (except HBFC), which was 23.5 days in March 31, 2010. Average time taken by HBFC presently is 39 days which is significantly higher than 30 days reported last year. This has increased overall industry average to 33.9 days. Currently, the application processing of most of the banks is centralized, where branches forward applications to central branches/head offices for assessment and approvals. The difference in processing time, in fact, is reflecting area of their lending. Since HBFC is mainly extending loans for construction purpose, which requires more time to evaluate. Whereas, commercial banks, particularly smaller banks have outsourced the legal and documentation work. However, it does not imply that the present situation is comfortable, all institutions in general and HBFC in particular should try to reduce processing time as many of the genuine deals require settlement in short time and a shorter processing time may help increase housing finance in the country.

Average loan size

Average loan size for disbursements made during the quarter ending Mar-2011 was Rs. 3.5 million for all banks, except HBFC. The average loan size for HBFC is reported to be Rs. 1.2 million for the reporting quarter. Islamic as well as private banks reported an average finance size of Rs. 2.1 and Rs. 4.5 million, foreign banks Rs. 2.4 million and public sector banks reported Rs. 2.5 million. The housing finance market is still inclined towards lending to high income groups.

5.0. Infrastructure Finance

The stock of infrastructure finance which was hovering around Rs. 260 billon, till Jun-2010 rose to Rs. 296.5 billion at the end of Mar-2011.

The disbursement figure for this quarter was Rs. 7.6 billion and again the power generation sector remained the major beneficiary with 84.3% share. The NPLs have also increased considerably from Rs. 6.7 billion in the preceding quarter to Rs. 10 billion whereas the same was Rs. 7.7 billion in Mar-2010.

The overall scenario did not present a rosy picture as shown by the financing trends. The importance of physical infrastructure cannot be overemphasized but the commensurate response is still lacking and leaving a lot to be desired. International experience emphasizes the need of institutional capacity for project development to achieve meaningful progress in infrastructure financing. All the developing countries have multiple institutions with varying degrees of mandate and functions peculiar to their economic needs but the common thread among them is they supply a pipeline of viable projects and means to provide long term fixed-rate financing.

5.1. Outstanding Portfolio

Total financing outstanding at close of Mar-2011 was Rs. 296.5 billion against Rs. 284.5 billion at the end of previous quarter ending Dec-2010. The volume of outstanding portfolio was Rs. 283.7 billion at the end of Mar-2010. The analysis shows, as in **Figure 5a**, that power generation sector stood out among all the sectors of infrastructure.

A number of factors like power policy, availability of sovereign guarantees in case of IPPs, expertise of financial sector in this area and demand of energy are the main reasons of its consistent lead over the other sectors.

Fig 5a: Outstanding of Top 5 Sectors

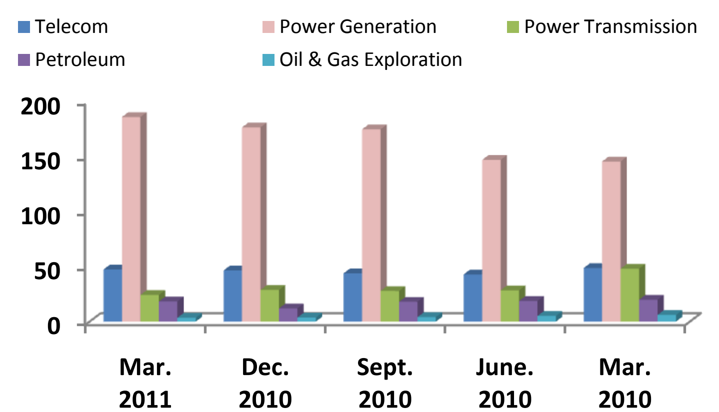
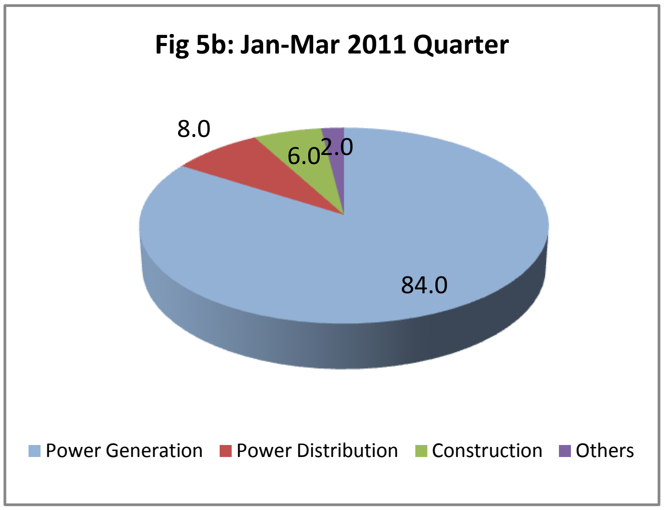


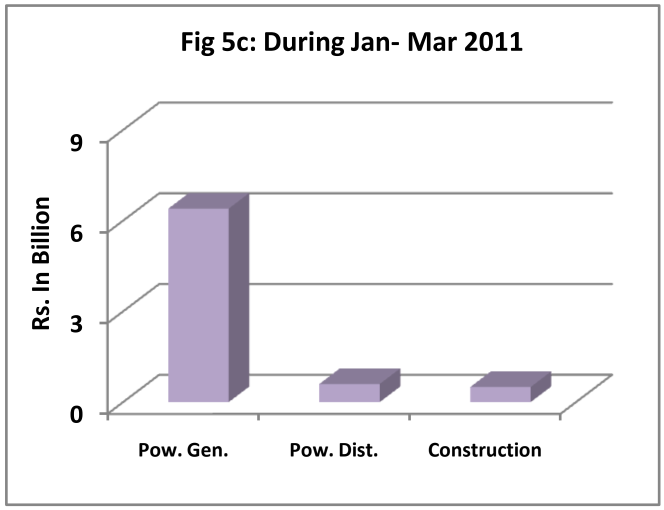
Figure 5a shows the quarterly position of top five sectors from March 2010 to March 2011. All the top five sectors, except power generation, are showing a decline in their respective volume of outstanding over the year.

However, a steep decline was witnessed in power transmission and distribution sector due to transfer of its outstanding from banks to a power holding company. The outstanding volume in this sector was Rs 47.8 billion at the end of Mar-2010 which reduced to Rs 28.6 billion at the end of Mar-2011.

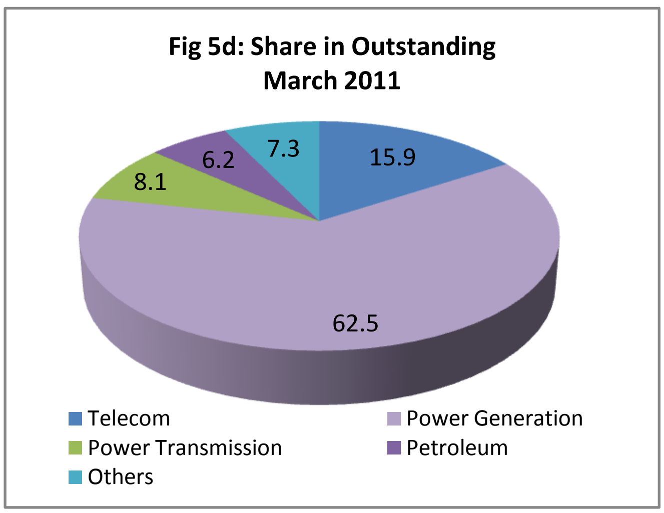
5.2. Disbursements

Total Rs. 7.6 billion were disbursed during Jan-Mar 2011 quarter in all infrastructure sectors against Rs. 12.0 billion in the previous quarter. The disbursement during Jan-Mar 2010 quarter was Rs. 9.6 billion. **Figures 5b & 5c** show the amount disbursed and share of each sector during the quarter under review. Power generation sector received Rs. 6.4 billion, which is a significant 84.3% share of overall disbursement. Power generation sector availed Rs. 5.4 billion in last quarter while it received Rs. 6.7 billion in Jan-Mar 2010. Power distribution sector got financing of Rs 568 million (8.0%) in this quarter while construction sector was recipient of Rs. 460 million (6.0%) in this quarter. Telecom and Ports & Shipping sectors were conspicuous by their absence in this quarter. The absence of bank financing in oil & gas sector has been a real concern considering its real potential to play an important role in the economic activity of the country.





5.3. Analysis of Sectoral Share in Infrastructure Portfolio



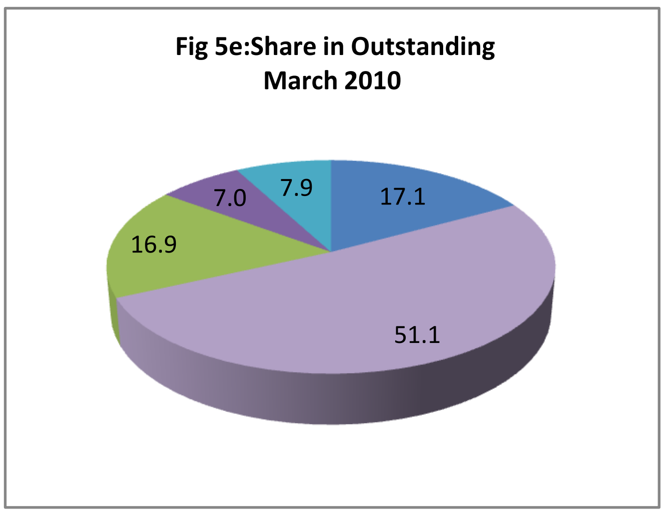
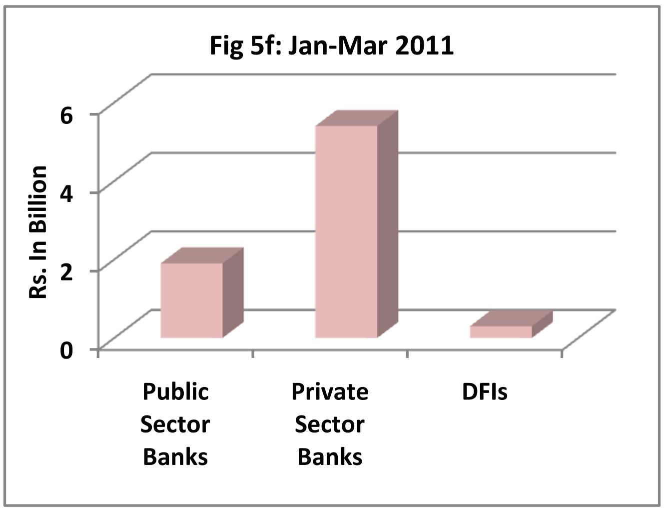


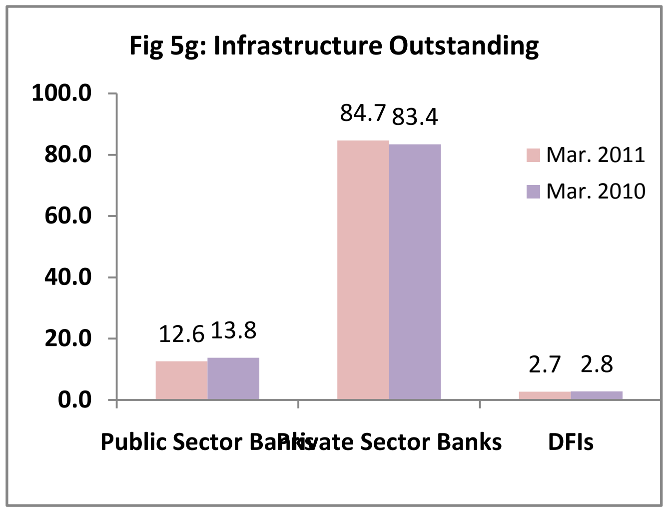
Figure 5d & 5e show the comparison of top five sectors in outstanding infrastructure financing at the end of Mar-2010 with the status existing on Mar-2011. At the end of Mar-2010, power generation sector had 51.1% of the total stock followed by telecommunication sector with 17.1%. After a year, the top slot continues to be held by power generation sector with a substantial 62.5% share in the pie. All other major sectors in graph showed a declining trend. Telecommunication sector remained at second place with 15.9% share. Petroleum sector, despite having huge potential, had been on the downside from 7.0% to 6.2% in a year. The decline in the share of power transmission sector is due to shifting of some of its outstanding amount to a power holding company.

5.4. Banking Sector-wise Performance

5.4.1. Banking Sector-wise Disbursements

Figure 5f show that private sector commercial banks disbursed Rs. 5.4 billion (71.5%) out of total Rs. 7.6 billion financing in infrastructure sectors during the quarter under review. Public sector banks disbursed Rs. 1.9 billion (25.5%) as against a substantially lower amount of only Rs.839 million (8.7%) in the corresponding quarter. DFIs disbursed only Rs. 229 million (3.0%) despite having a mandate of development finance. In same quarter last year, private sector banks disbursed Rs. 8.4 billion (87.8%) and DFIs' share in disbursements during the quarter ending Mar-2010 was also minimal at Rs. 335 million (3.5%). A rise in the share of public sector banks in





infrastructure financing during Jan-Mar 2011 is probably due to their active role to support IPPS facing financial difficulties amidst unresolved circular debt issue.

5.4.2. Banking Sector-wise Share in Outstanding

Figure 5g shows category-wise share of banking sector in outstanding stock of infrastructure financing. The trend remains almost the same throughout the year. Share of private sector banks rose marginally from 83.4% to 84.7%, while share of public sector banks declined from 13.8% to 12.6% after a year. The share of DFIs remained below par through-out the year. Though private banks enjoy a major share, portfolio diversification beyond limited infrastructure sectors is highly desirable.

6.0. 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 ended March 31, 2011.

Revision in Credit Guarantee Scheme for Small and Rural Enterprises

SBP had earlier launched a Credit Guarantee Scheme (CGS) for Small and Rural Enterprises in March 2010, which allowed banks to develop a portfolio of fresh borrowers who are creditworthy, but cannot fit into their usual credit parameters, especially when collaterals are required. The scheme was modified in February 2011 and important features were made part of it; which include sharing 40 percent of bona-fide losses of PFI's credit portfolio, removal of interest rate cap and bifurcation into two components, introducing eligibility of farmers with Economic Landholding and increasing their loan size from Rs. 0.5 million to Rs. 2 million, giving definition of Small Enterprises and increasing loan limit from Rs. 5 million to Rs. 15 million.

SME Training Programs

SBP held two Gross Root Cluster Training Programs at Faisalabad & Islamabad that focused on key areas of risk-management, product development and marketing tools etc.

SME Market Segmentation in Pakistan

SBP in collaboration with IFC launched a joint research project to provide credible information base on key SME clusters/sub-sectors of economic importance in Pakistan. The broad objective of this research project is to create an information resource that can be used by lending institutions for identifying priority SME segments and targeting them through appropriate banking products and marketing/distribution strategies. The project has been completed.

SME Finance Conference

International Finance Corporation (IFC), in collaboration with the State Bank of Pakistan, organized a conference titled "SME Banking Conference; Global & Local Trends and Role of Non Financial Services to SMEs" in Karachi on March 15, 2011 at SBP Learning Resource Centre which was attended by senior officials from SBP, Heads of SME Banking, Agriculture Finance, Micro Finance and other Senior Local Bankers and representatives of SME associations.

The Governor SBP delivered the keynote address while the speakers included senior officers of SBP, the IFC, practitioners of SME Banking from local as well as foreign banks, Adviser Private & Financial Sector Development, DFID Pakistan, and CEO, Business Support Fund who shared their experiences of SME Banking and Management Practices, Strategies, and Tools.

Total Write Off of Loans

In pursuance of Prime Minister's announcement of relief package, SBP vide SMEFD Circular No. 1 dated February 2, 2011 announced a procedure for reimbursement of subsidy on account of write off of loans outstanding as of December 31, 2009 against the borrowers of Malakand, Swat, Buner and Chitral districts under above Fiscal Relief Package. The loans booked in above-mentioned areas and also booked outside on behalf of businesses operating /located in these districts qualify for reimbursement of subsidy. Only principal amount of outstanding loans (Performing and NPLs less provisioning) as of December 31, 2009 shall be qualified for subsidy. Further, banks, DFIs and MFBs shall bear the cost of such write-offs to the extent of amount held into provision against NPLs and interest in suspense account, while the rest of the cost will be paid by the Government of Pakistan as subsidy. The banks, DFIs and MFBs were advised to submit their claims to SBP-BSC (Bank) Peshawar **up to March 15, 2011** which was later extended to April 15, 2011.

Fiscal Relief for package Rehabilitation

On release of budgetary allocation by the Ministry of Finance on account of Mark Up Rate subsidy against outstanding loans of the borrowers of Textile sector and Other Eligible Sectors of Khyber Pakhtunkhwa, Federal and Provincial Administered Tribal Areas, SBP vide SMEFD Circular Letters No. 1 & 3 dated January 15 & 28, 2011 respectively advised Banks/DFIs to release 2nd installment of the subsidy under the Scheme for the period from 01-07-2010 to 31-12-2010. Accordingly, banks/DFIs/MFBs were advised to submit claims by February 15, 2011 in favor of Textile Sector and February 28, 2011 in favor of Other Eligible Sectors keeping in view the terms & conditions of the Scheme.

Eligibility of Glass Sector under LTFF

To increase exportable goods of glass sector, SBP vide SMEFD Circular Letter No. 2 dated January 20, 2011, announced that plant, machinery & equipment to be used by the export oriented projects in glass sector shall also be eligible under the LTFF Scheme.

Revised Maximum Borrowing Limit under LTFF

In order to meet growing demand of the stakeholders, State Bank of Pakistan vide SMEFD Circular Letter No. 04 dated February 14, 2011 enhanced the maximum financing limit to a single export oriented project from Rs. 1,000 million to Rs. 1,500 million under the Long Term Financing Facility (LTFF) Scheme for Plant & Machinery.

Requirement of Projected Exports under LTFF

The State Bank vide SMEFD Circular Letter No. 05 of February 14, 2011 advised banks/DFIs to entertain financing requests of New Project or Expansion / BMR of Existing Projects on the basis of projected exports adding that Minimum Export Target [viz. annual exports of US$5 million or 50% of sales, whichever is lower] will be met within a maximum period of four (04) years, from the date of grant of refinance from SBP-BSC (Bank), in a phased manner. In the first phase, 40% of the export target would be required to be met in first two years while remaining 60% target will be met during next two years or total tenor of loan, whichever is less.

Clarification on Export Overdue Proceeds

To facilitate exporters having export overdue proceeds for availing financing under EFS, SBP vide SMEFD Circular Letter No. 06 dated February 24, 2011 extended waiver for further six months up to June 30, 2011 from Dec 31, 2010 for the purpose of availing financing under EFS by those exporters having overdue export proceeds at the time of availing the facility.

Payment of Outstanding Claims

On budgetary allocation for FY 2010-11 by Ministry of Textile Industry, SBP vide SMEFD Circular Letter No. 07 dated February 24, 2011 announced to release remaining 8% **Export Finance Mark up Rate subsidy** for the period from 01.09.2009 to 28.02.2010 of total claims against the cases which have been found in order and where 92% reimbursement has already been made to banks under the Scheme. Banks were advised to pass on this additional reimbursement immediately to the concerned exporters.

Major Steps concerning Micro-financing during the Quarter

- On 24th January, 2011, SBP launched a medium term strategic framework for sustainable microfinance in Pakistan. The new strategic framework provides a road map for the development of sustainable microfinance to foster financial inclusion. The policy focus remains on promoting market-based financial services that meet the diverse needs of poor and low-income segments. Specifically, the new strategy focuses on:
    - Improving the quality of growth through promoting inclusive financial services with up-scaling credit operations;
    - Encouraging innovations to achieve rapid scale and reduce operating costs;
    - Promoting organizational development through effective governance and professional management at strategic, middle and operational levels; and
    - Improving sector discipline through consumer protection policies, financial literacy programs, and exploring options to bring non-regulated MFIs under a minimum regulatory framework.
- SBP, vide MFD Circular No. 01 of 2011 dated January 01, 2011, issued instructions for 'record retention' to MFBs. The minimum requirements are given as follows:
    i) MFBs shall keep record on the identification data obtained through the Customer Due Diligence (CDD) process, account files and business correspondence for at least five years following the termination of the business relationship.
    ii) MFBs shall maintain all necessary records on transactions, both domestic and International, for at least five years following completion of the transaction. Such records must be sufficient for reconstruction of individual transactions so as to provide, if necessary, evidence for investigation or prosecution of criminal activity.
- In March 2011, NRSP Microfinance Bank commenced its business as a nationwide microfinance concern. Initially, it will operate with a network of 38 branches in 13 districts of the country. This will lead to increased offering of inclusive financial services in rural areas.
- KBL in collaboration with Western Union commenced pilot home remittance business.
- Tameer MFB introduced two new loan products: i) Gold Card: a secured and revolving credit line, and ii) Warehouse Receipt Financing: to offer warehouse receipt financing/inventory credit to the farmers.
- Pakistan Poverty Alleviation Fund (PPAF) and Pakistan Microfinance Network (PMN) partnered to develop and launch an online platform that will allow microcredit lenders and other stakeholders to assess competitive situation in their specific markets.

Knowledge Sharing Session with Central Bank of Indonesia

SBP arranged a knowledge sharing program on Rural & Microfinance Policy Environment and Regulatory Framework whereby a delegation of senior officials of Bank Indonesia visited SBP from 24-27 January, 2011. The program was arranged at the request of APRACA (Asia-Pacific Rural & Agricultural Credit Association) under IFAD funded Fin-power knowledge sharing program among central banks.

During the visit, meetings/discussions of the delegates were arranged with policy makers & practitioners of agri/rural finance and microfinance including senior executives / officials of various departments of SBP, agri. lending banks, Microfinance Banks and farmers' associations. For grass root level know-how, field visits to Model Agricultural Farm and Microfinance groups of Khushhali Bank at Tando Allahyar were also arranged.

Training Workshop for CAD/Risk Management Departments of Banks

To develop the understanding of CAD & RMD officials of banks about the dynamics of agri. lending, SBP developed two days training workshop on important topics such as overview of agri. sector, SBP regulations regarding agri. finance, agri. credit risk management tools & techniques, loan appraisal and documentation, agri. passbook and other documents of revenue department, etc. in consultation with banks. In this connection, two training workshops were held at Faisalabad and Gujranwala during the quarter, which were attended by around 50 senior officials of agri. lending banks, SBP and DFSD, SBP-BSC. So far, three such programs have been held during this fiscal year.

Policy Adequacy and Awareness Seminars on Agri. Financing

To educate 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 Seminars on Agri. Financing" at University College of Agriculture & Environmental Sciences, Islamia University Bahawalpur and College of Agriculture, Dera Ghazi Khan on 30th and 31st March, 2011 respectively.

The participants were briefed about various tools & techniques of agri. financing including guidelines & schemes, products, processes, value chain of activities, forward & backward linkages, , etc. The speakers also responded to the questions from the audience and gave outline of the internship program at banks, specially designed for agri. graduates. The seminars were attended by a large number of students, teaching faculty, academia, chief managers of SBP-BSC Offices, officials of DFSD, SBP-BSC and senior officials of banks.

Streamlining of Agricultural Lending Procedures and Documentation

To ensure timely disbursement of agri-credit to the farming community, ACD vide its Circular No. 02 of 11th August, 2010, revised the list of documents to be obtained by banks against various kinds of agri-loans and streamlined the turnaround time for agri-loan processing.

Further, to strengthen the existing agri. lending structure and remove lapses in agri. loan management, banks were advised to take measures like; a comprehensive Agricultural Finance policy in line with PRs, set up and maintain a fully dedicated Agri. Finance Department/Division/Unit equipped with qualified agri. financing staff, develop an overall annual regional agricultural portfolio plan, increase number of agri. designated branches and ACOs, delegate adequate powers to agri. designated branches for sanctioning small agri. Loans, launch financial literacy programs for awareness of the farming community, etc. by the end of the last calendar year. While a number of banks were fully compliant, few other agri. lending banks lacked in some areas, for which they were advised to remove the shortcomings by 30th June, 2011.

Moreover, banks which are not engaged in agri. financing and have significant branch network/ presence in the rural areas were advised to take necessary measures to ensure compliance with SBP instructions by 31st December, 2011, however, banks with limited branch network were asked to reassess their business strategy and include agri. financing as a viable business in their banks' future plan.

Implementation of Housing Advisory Group's Recommendations

As part of its earlier efforts, SBP had established a Housing Advisory Group (HAG) with an intention to conduct a thorough analysis of the existing regulatory and policy framework affecting housing finance. The HAG made number of recommendations stressing on the need to enhance access of financial services for the development of housing sector. These include reforms in legal and regulatory framework, establishment of secondary mortgage market, development of market intelligence, provision of affordable/low income housing finance products. SBP disseminated the recommendations to the concerned stakeholders and is currently coordinating with provincial governments, Pakistan Banks' Association (PBA), Association of Mortgage Bankers (AMB) and Association of Builders and Developers (ABAD) for implementation of some of the key recommendations.

Mortgage Refinance Company

Work on the establishment of Mortgage Refinance Company is being pursued aggressively. IFC developed a detailed business plan and feasibility for the Mortgage Refinance Company. Principal buy-in of the Ministry of Finance has been elicited and equity commitments from the GoP, commercial banks and HBFC have been received. Memorandum & Articles of Association of the proposed company have been developed and consultant is being hired to assist in incorporation of the company during the current financial year (2010-11).

Capacity building Program

In addition to initiatives taken to institutionalize housing finance, SBP realizes that a simultaneous development of human capital will play a critical role in ensuring sustainability of housing finance. Few training programs have been conducted on different aspects of housing finance including product development, loan marketing/distribution and origination & loan underwriting, servicing and risk management. Till date, approximately 400 bankers from over 20 banks have been trained in the mortgage business.

Development of Housing Finance Guidelines

To increase the efficiency of mortgage bankers, Housing/Mortgage Finance Guidelines have been developed, by adopting best international practices, and after consultation with internal and external stakeholders, including PBA.

7.0. Development Finance News From Around The World

The following are some of the important news concerning Development Finance across the Globe during the year first Quarter of 2011.

IFC invests $10 million in East Africa's private equity fund

The International Finance Corporation (IFC), a member of the World Bank Group, on 8 March announced it was investing $10 million in equity in Catalyst Fund I LLC. The fund aims to stimulate employment and accelerate economic growth across East Africa by improving access to equity financing for emerging and mid-size companies. The fund will invest in growth companies with dynamic management to drive growth, regional expansion, consolidation, and performance improvement. Investments in target companies will range from $5 million to $15 million.

ETDB expands its SME financing towards Orix Leasing

ECO Trade and Development Bank's (ETDB) Board of Directors approved SMEs (Small and Medium Enterprises) credit facility to Orix Leasing Pakistan Limited for a total limit of up to $10 million with a tenor of 4 years and a grace period of 1 year. ETDB believes SMEs have a vital role to play as engines of economic growth in the ECO region including Pakistan and this facility will be in line with the Bank's mandate to become a driving force in the economic development of ECO member states by supporting and encouraging investments in high priority sectors such as SMEs.

IFC out to rally small business financing

The International Finance Corporation (IFC), a member of the World Bank Group, is set to bring together several experts from Africa's financial sector in a move aimed at increasing lending to Small and Medium Enterprises ; it said it would host African bankers at the 2011 Africa SME banking conference in South Africa, scheduled for May 2011. According to a statement from the IFC, the event would seek to discuss ways of overcoming barriers blocking the growth of small businesses in Africa.

Google's Initiative in Empowering Indian SMEs

In its unique endeavour in empowering India's small and medium sector, Google India announced the extension of its free advertising coupons offer for SMEs across India. As part of this initiative Google India also announced a new service called Jumpstart wherein – Google will offer free expert support to help enterprises build an online advertising campaign to attract new customers. The new service is likely to provide a quick-and-easy way to SMEs to get their Google advertising campaign off to a successful start. Google's specialists will work directly with SMEs to set up their ad words account and build a customised campaign that suits their business and the budget. Introduced in Chandigarh as a pilot, this initiative has received immense appreciation by small-medium businesses across India. Responding to this popularity, Google India is extending this initiative to empower more and more SMEs.

Dubai SME and Potential launch SME Evolution Program in Arabic

Dubai SME, the SME development agency of the Department of Economic Development (DED) in Dubai and Potential, a UAE-based business development company, announced the launch of the Arabic version of its SME Evolution Programme in a bid to enhance the initiative's reach and invite heightened participation from SMEs. It is the first of its kind free web-training that offers practical support to enterprises and enables them to compete effectively on the international marketplace.

Pakistan thanks Turkey for building homes in flood-hit area, requests for building more houses

Thanking the Turkish government for building 4,620 houses in the flood-affected area, Pakistan has requested the Housing Development Administration of Turkey (TOKI) to build more houses in the country. The request was made by Deputy Speaker of Pakistan's National Assembly in his meeting with TOKI President at his office.

The TOKI president said Pakistan needs urgent housing and this can be achieved by establishing house manufacturing factories to build low-cost houses on a fast track.

Indian Affordable Housing Demand Set to Grow at 13% CAGR

According to our research report "Indian Housing Sector Analysis", real estate section in India has emerged as one of the most dynamic sections. The country's housing industry has been experiencing tremendous growth for the past few years. Moreover, with increase in number of real estate developers, rise in demand for properties, and availability of financing options, India housing sector is expected to propel in near future.

The ongoing research analysis found that, the affordable housing segment accounts for the major share in the India housing industry, both in terms of volume and value.

Call to freeze housing finance to single digit

The government must freeze the housing sector finance for at least 10 years into single digit to promote the construction industry and to meet the country's housing demands.
Participants in the Jang Economic Session on the 'Role of Housing Sector in National Economy' added the country needs 0.5 million units per annum and only 0.2 million houses were being constructed.

It was observed that the construction industry runs 40 other industries at parallel, which create real economic activity in the country. They stressed the need to promote vertical housing construction, which was relatively cheaper as compared to traditional housing units. They called for the implementation of Housing Policy 2001 approved by the cabinet and also suggested introduction of modern technology in housing construction, which was used all over the world, which was also helpful in promoting the construction industry.

China introduces first property tax for home buyers

China has introduced its first property tax for home buyers to try to curb record house prices and tame inflation. The measure, which came into effect on Friday, will apply to those buying second homes in Shanghai and Chongqing. The tax, paid annually, is between 0.4% and 1.2% of the purchase price, depending on how the price compares with market averages.

Property prices are one of the main drivers of Chinese inflation, which Beijing is keen to keep under control. China's economy is growing far faster than that of any other major country. Its GDP grew by 10.3% last year – the fastest annual pace since the financial crisis. In Shanghai, buyers will pay between 0.4% and 0.6% tax on their new second homes. In the south western city of Chongqing, the tax is more staggered, ranging from 0.5% to 1.2%.

8.0. Special Section – Financial Literacy

*Financial education is the process by which financial consumers/investors improve their understanding of financial products and concepts and, through **information**, **instruction** and/or objective **advice**, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being.*

Financial literacy has assumed greater importance in the recent years, as financial markets have become increasingly complex and increasing use of technology has made it possible for banks to reach to the doorstep of each potential customer.

Financial literacy is considered an important addition for promoting financial inclusion and ultimately financial stability. Both developed and developing countries, therefore, are focusing on programs for financial literacy/education. Changes in the way the financial markets operate, number and types of financial products, widespread use of informal lending in developed countries and its implications on stability of financial systems, objectives of financial inclusion, increasing number of financial service users with limited background knowledge, increasing per capita income and other demographic changes are some of the motivating factors inducing government departments, financial and capital market regulators around the world to undertake measures for increasing basic knowledge of financial literacy among the populace.

Despite quite extensive Financial Literacy Programs in the developing countries, the Surveys still highlight that the scope of work is quite broad. The need for financial literacy is highlighted in surveys in United States, Japan, Australia, UK and other developed countries. Though the developed countries are leading in their measures, developing countries like India are also taking extensive measures for creation of financial literacy. Financial literacy efforts of countries are more focused on publications of books, pamphlets, brochures, and other financial literacy literature material and its dissemination, creation of extensive and interactive web-portals both for school going young children and for adults, awareness seminars, training sessions, interactive programs, video series, creation financial counseling structures and mandating extensive role of financial institutions in financial literacy through rules and regulations, etc.

Financial literacy is the ability to understand finance. More specifically, it refers to the set of skills and knowledge that allows an individual to make informed and effective decisions through their understanding of finances. Raising interest in personal finance is now a focus of state-run programs in countries including Australia, Japan, the United States and the UK.

The Organization for Economic Co-operation and Development (OECD) started an inter-governmental project in 2003 with the objective of providing ways to improve financial education and literacy standards through the development of common financial literacy principles.

In March 2008, the OECD launched the International Gateway for Financial Education, which serves as a clearinghouse for financial education programs, information and research worldwide. In the UK, the alternative term “financial capability” is used by the state and its agencies: the Financial Services Authority (FSA) in the UK started a national strategy on financial capability in 2003. The US Government also established its Financial Literacy and Education Commission in 2003.

In July 2010, the United States Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which created the Consumer Financial Protection Bureau (CFPB). The CFPB has been tasked, among other mandates, with promoting financial education through its Consumer Engagement & Education group.

An international OECD study was published in late 2005 analyzing financial literacy surveys in OECD countries. A selection of findings included:

- In Australia, 67 per cent of respondents indicated that they understood the concept of compound interest, yet when they were asked to solve a problem using the concept only 28 per cent had a good level of understanding.
- A British survey found that consumers do not actively seek out financial information. The information they do receive is acquired by chance, for example, by picking up a pamphlet at a bank or having a chance talk with a bank employee.
- A Canadian survey found that respondents considered choosing the right investments to be more stressful than going to the dentist.
- A survey of Korean high-school students showed that they had failing scores - that is, they answered fewer than 60 per cent of the questions correctly - on tests designed to measure their ability to choose and manage a credit card, their knowledge about saving and investing for retirement, and their awareness of risk and the importance of insuring against it.
- A survey in the US found that four out of ten American workers are not saving for retirement.

“Yet it is encouraging that the few financial education programmes which have been evaluated have been found to be reasonably effective. Research in the US shows that workers increase their participation in 401(k) plans (a type of retirement plan, with special tax advantages, which allows employees to save and invest for their own retirement) when employers offer financial education programmes, whether in the form of brochures or seminars.”

The organization for Economic Cooperation & Development’s (OECD’s) *“Recommendation on Principles and Good Practices for Financial Education and Awareness”* includes the following advice to governments:

- Governments and all concerned stakeholders should promote unbiased, fair and coordinated financial education.
- Financial education should start at school, for people to be educated as early as possible.
- Financial education should be part of the good governance of financial institutions, whose accountability and responsibility should be encouraged.
- Financial education should be clearly distinguished from commercial advice; codes of conduct for the staff of financial institutions should be developed.
- Financial institutions should be encouraged to check that clients read and understand information, especially when related to long-term commitments or financial services with potentially significant financial consequences: small print and abstruse documentation should be discouraged.
- Financial education programs should focus particularly on important life-planning aspects, such as basic savings, debt, insurance or pensions.
- Programs should be oriented towards financial capacity building, where appropriate targeted on specific groups and made as personalized as possible.
- Future retirees should be made aware of the need to assess the financial adequacy of their current public and private pension's schemes.
- National campaigns, specific Web sites, free information services and warning systems on high-risk issues for financial consumers (such as fraud) should be promoted.

Financial Literacy of SMEs in Pakistan

In the business context in Pakistan, a vibrant SME Sector may contribute significantly in economic development, employment generation, export revenues and poverty alleviation. The hard-wired entrepreneurship skills of Pakistanis can be witnessed in pockets of SME Clusters scattered across the country where availability of only a tinge of information have led to their prolific growth. These SME clusters can be viewed as role models of development and their success stories may be retold in other areas to increase financial awareness. However, these SME Clusters are vulnerable to external pressures and need to be nurtured to remain afloat and ward off possible exigencies/downturn. Adding further to the argument, SME Clusters have not reached their saturation point and expansion of awareness base among these areas will help not only in growth of their numbers but also subsequent migration of a number of them to the corporate status.

SMEs and particularly Small Enterprises are generally unaware of the financing facilities available to them from formal sources of financing. They do not know the correct way to approach the banks and present their financing position so as to avail best possible financing facilities from them. They generally fail to assess the differences in features of financing products and especially they do not have a clear understanding of mark-up rates, tenures of lending facilities, repayment schedule and customer evaluation requirements of the banks. The only viable remedy to this situation is the creation of awareness i.e. financial literacy of SMEs.

Summarizing, in order to ensure healthy continuity and steady growth of enterprises, a viable relationship between financial institutions and SMEs is extremely important. The financial institutions have vast network of financial partners across the globe; and most importantly, they understand the needs of SMEs and have prudent solutions. It is only their distorted image and lack of awareness among SMEs which is hindering the later to put their trust in banks.

Possible Interventions for improving Financial Literacy

Publications

Publications are probably the most extensively used medium for spreading information and financial literacy and there is a strong need for banks to use this medium effectively. The banks may publish booklets/pamphlets/ brochures elaborating feature of their lending products for SMEs in Urdu and other regional languages and also arrange for elaborate dissemination/ display of these materials.

Central Portal

The creation of an interactive informative web portal with basic knowledge of functions of State Bank, basic elements of savings and lending products, specialized sections containing information on prudential regulations, SBP developmental initiatives, and various SME related schemes and children knowledge section etc may help those who have access to the internet. The *Urdu* version and possibly the regional languages versions of this web-page on the lines of Indian informative web-portal may also be made available.

Financial Counseling

Financial counseling serves three purposes. First, it examines the ways to solve current financial problems. Second, by educating about the costs of misusing a credit, it improves financial management. Third, it encourages the distressed people to access the formal financial system. In view of success of financial (credit) counseling systems in developed countries like USA and UK, many developing countries around the world are opting to have such a structure.

In Pakistan, financial counseling desks may be established in major cities where SMEs may approach for availing free access to information on various banking products & services as well as counseling facility provided by trained personnel posted in the centre. The counseling desks may be hosted in offices of SBP-BSC, branches of major banks and even SMEDA and retired bankers having extensive experience of dealing with SME clients may be appointed in these field offices.

Role of banks

- **Interactive sessions with SMEs:** Banks may have regular interactive sessions with SME associations to sort out their issues and try to find out a reconciliatory way towards improvement of SME banking.
- **Advertising Campaign:** Banks may also use the local electronic and print media for advertisement of their products in different SME clusters and regions.
- Banks may also arrange financial literacy campaign for SMEs with regards to their products in different SME clusters and regions across Pakistan.

Seminars for Awareness

Various awareness building measures, by Banks/SBP, e.g., seminars/workshops series, may prove instrumental in raising the level of awareness among SMEs regarding the lending programs of financial institutions and their delivery mechanisms. The seminar series may have thematic topics with regard to SME Finance, for instance a whole event can focus on a single topic such as; use of Branchless banking in expanding SME Banking, Developing low cost delivery channels, Risk assessment framework for SME Finance, Beyond SME Financing: The case of SME Banking, etc. Local offices of Banks/SBP may provide administrative and logistic arrangements of these seminars. Additionally, the field offices may get necessary support and encouragement to hold similar SME finance awareness workshops/seminar in respective field offices in a cost effective manner.

Awareness Building for School and College Goings

As a long term strategic measure, Bank/SBP Local Offices and Financial Counseling centers may be utilized for arranging presentations and activities regarding the role and functions of banks, various products and features of the saving schemes, simple mark-up calculations across the country. Big five banks may be also be utilized for this purpose.

9.0. Development Finance - Future Outlook

The Development Finance (DF) sectors have witnessed slowdown in the last few quarters, i.e., the total DF portfolio declined to Rs. 840.6 Billion, showing a decrease of 1.9 percent on YoY basis. Similarly, non performing loans (NPLs) of DF sector increased to Rs. 163.9 billion, recording a 21.2 percent increase on YoY basis, while the quarterly rise was recorded at 9.2 percent at the end of Mar-2011. The decline in DF portfolio and rising NPLs may be attributed to the prevailing economic slowdown, power outages, high inflation, domestic law & order situation, natural calamities, and overall shyness of the industry towards the sectors.

However, despite the prevailing adverse conditions, there still exists a strong reason for a positive course of action to take place, as a result of greater realization on the part of SBP, GoP, the banking industry and other stakeholders, to play a more effective role for the development of the subject sectors. Further, 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.

Thus, going forward, a positive turnaround is probable provided the relevant stakeholders play their role in a more meaningful and effective manner. However, it would be unrealistic to expect a change that could bring drastic improvement in the overall economic situation in general and DF sectors in particular; as rising inflation, poor law and order situation and dependence of the government on budgetary borrowings from the banking sector harms positive growth in the DF sectors of SMEs, Micro, Agriculture, Infrastructure and Housing.

The State Bank, on its part, has taken various important initiatives for the development of the DF Sector that will cause positive impact on the availability of funds for the sector and its overall development in the long run. Some important initiatives include improvements in Credit Guarantee Scheme for Small & Rural Enterprises, Microfinance Credit Guarantee Scheme, Refinance Scheme for Revitalization of SMEs, Scheme for modernization of SMEs, Cluster Profiling Surveys, introduction of Branchless Banking, Launch of Pilot MF-CIB (will soon be launched at national level), Mortgage Refinance Company and Capacity Building/Awareness Programs for the stakeholders.

Development Finance Reviews Published by SBP

Development Finance Quarterly Review (Mar-2011)

Development Finance Review (Dec-2010)
Development Finance Quarterly Review (Sep-2010)
Development Finance Quarterly Review (Jun-2010)
Development Finance Quarterly Review (Mar-2010)

Development Finance Review (Dec-2009)
Development Finance Quarterly Review (Sep-2009)
Development Finance Quarterly Review (Jun-2009)
Development Finance Quarterly Review (Mar-2009)

Development Finance Review (Dec-2008)
Development Finance Quarterly Review (Sep-2008)

These Reviews are available at
http://www.sbp.org.pk/SME/DFG.htm