‘April-June 2010’

Quarterly Infrastructure Finance Review

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Pakistan Infrastructure Scenario

Pakistan's infrastructural situation is relatively poor by international standards and this has a significant impact on the lives of every Pakistani in the country. Acute shortage of electricity has turned this necessity into a luxury. Large portion of population do not have access to proper drinking water and sanitation facilities. The Government of Pakistan and its people face an uphill battle against poor infrastructure and it seems like the latter is winning as the country is going through the worst power crisis in its history, with electricity shortage of around 4000 MW. With an estimated 5% annual growth in demand, the country would need additional capacity of approximately 10,000 MW by 2016. The improvement and expansion of infrastructure is a pre-requisite for sustaining and accelerating economic growth and social development in a country. Improving quality and service coverage in crucial sectors like power, water supply and sewerage treatment, transport and logistics is critical for Pakistan's economy and to improve the quality of life of its citizens.

It is estimated that due to insufficient infrastructure, Pakistan looses about 4 to 6 percent of its GDP (approximately $6 billion). Logistical bottlenecks increase the cost of production by about 30%. This has a significant impact, as Pakistan is facing stiff competition from the likes of India and China in the export markets. To improve and expand infrastructure, Pakistan's needs are massive and its resources are limited. Not only is there limited fiscal space, there are also huge gaps in public sector capacity to build and operate infrastructure. Tight fiscal indicators such as fiscal deficit, trade deficit and current account deficit do not permit to spare sufficient public sector resources for infrastructure development. A study suggests that to sustain a 7% GDP growth would require an investment about 7 % of GDP.

In the last three decades, Pakistan has been facing a high rate of urbanization and population growth. The consequences of such unprecedented changes are seen in the form of unplanned, unregulated and uncontrolled urbanization which pose a major problem to the city dwellers. Provision of adequate infrastructure facilities is a perpetual problem, which is needed to be tackled on urgent basis.

Overview of infrastructure Finance:

The stock of infrastructure finance hovered around Rs. 260 billon throughout the year. Though there was no major shift in total outstanding portfolio of infrastructure project finance but some internal shifts within different infrastructure sectors were observed. The outstanding stock of Power Generation sector escalated significantly from Rs. 115 billion in June 2009 to Rs. 146.5 billion in June 2010. The 27.4% increase in Power Generation sector is, however, much lower than staggering 116% increase witnessed in the volume of Power Generation from June 2008 to June 2009. The quantum of overall disbursement was Rs. 10.3 billion in this quarter which was Rs. 9.1 billion during the previous quarter while the same was Rs. 21.9 billion during April-June, 2009. There is around 53% downfall in volume of disbursement on YoY basis. As in the previous quarters, Power Generation sector remained principal contributor with disbursement of about Rs. 6.3 billion. Total NPLs stood at Rs. 7 billion for this quarter while same were Rs. 7.8 billion during previous quarter.

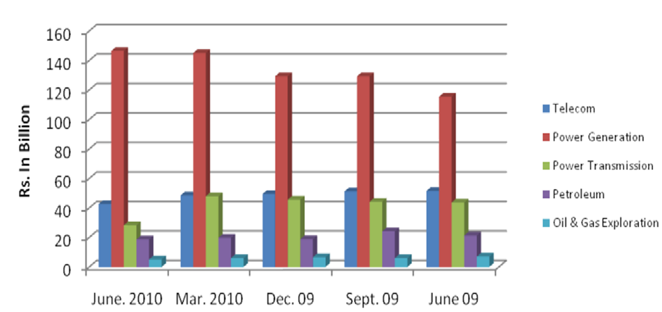
One important signifier of infrastructure development is the number of new projects who get financial close and the figures pointed towards a worrying fact that during FY 10, only 10 new projects got financial close against 53 projects in FY 09. Majority of new initiatives were taken in power generation sector. The international and indigenous experience shows that private sector only participates when there is clear assurance of project's viability and government's support, wherever required. The role of DFIs is very disappointing as they have only around 2% share in total outstanding portfolio of infrastructure project finance.

Outstanding Portfolio:

Total financing outstanding at close of June, 2010 was Rs. 260 billion against Rs. 283.7 billion at the end of previous quarter of March 2010. The volume of outstanding portfolio was same at the end of June 2009 and June 2010 peaking in March 2010 with Rs 283.7. The analysis shows, as in figure 1, that power generation sector stood out among all the sectors of infrastructure, but the growth became stagnant this quarter. A number of factors like power policy, expertise of financial sector in this sector and demand of energy were the main reasons of its solid growth until March 2010, but the pace has slowed down as no new initiative is reported and the issue of circular debt is persistently hounding this sector for quite some time.

Figure 1 shows the quarterly position of top five sectors from June 2009 to June 2010. All the top five sectors, except Power Generation, are showing a decline in their respective volume of outstanding since the end of last quarter. However, the steep decline was witnessed in Power Transmission and Distribution sector. The outstanding volume in this sector was Rs. 47.9 billion at the end of March 2010 which reduced to Rs. 28.3 billion at the end of the quarter under review.

Fig. 1: Quarter-wise Value of Outstanding Stock in Top 5 Infrastructure Sectors



Disbursements:

Total Rs. 10.3 billion were disbursed during Apr-June 2010 quarter in all infrastructure sectors against Rs. 9.6 billion in the previous quarter. The disbursement during Apr-June 2009 quarter was Rs. 38 billion. Figures 2 and 3 show the amounts disbursed and share of each sector during the quarter under review. Power generation sector received Rs. 6.3 billion (61.2%), which is significantly higher than other sectors. Share of power generation sector in disbursement was also significantly higher in previous quarter at 69.7% (Rs. 6.7 billion) whereas it was 53.3% (Rs. 11.7 billion) during Mar-June 2009 which shows that there was a relatively more active scenario in infrastructure sectors a year ago. Telecommunication sector was conspicuous by its absence in this quarter while both Power Transmission and Petroleum received only Rs. 759 million and Rs. 264 million respectively in this quarter. The absence of oil & gas sector has been a real concern considering its important role in the economic activity of the country, while Port & Shipping sector saw, for the first time in last two years, any meaningful activity.

Fig. 2: Disbursements in Infrastructure Sectors During April.- June 2010

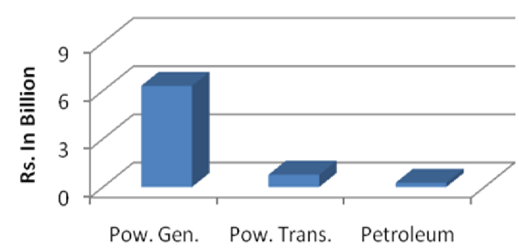
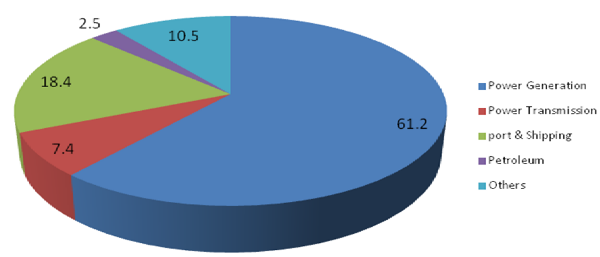


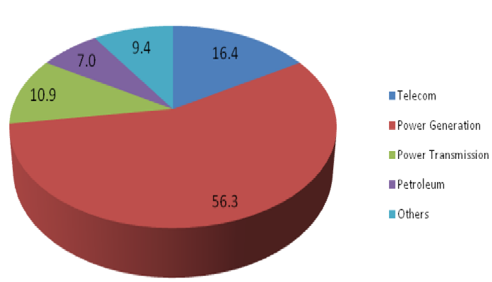
Fig. 3: Share in Disbursement by Infrastructure Sectors During April.- June 2010 Quarter



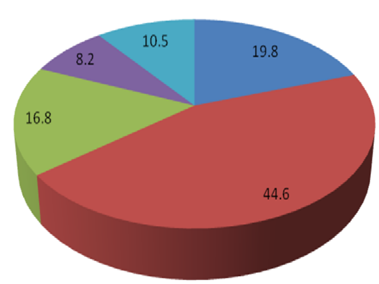
Analysis of Sectoral Share in Infrastructure Portfolio:

Figure 4 shows the comparison of top four sectors in outstanding infrastructure financing at the end of June 2009 with the status existing on June 30, 2010. At the end of June 2009, power generation sector had 44.6% of the total stock followed by telecommunication sector with 19.8%. After a year, the top slot continues to be held by power generation sector with a substantial 56.3% share in the pie. Since the overall outstanding portfolio of infrastructure was more or less same over the year so the declining market share of different sectors is due to the declining volume of outstanding stock of these sectors. The telecommunication sector remained at second place with 16.4% share followed by power transmission sector at 10.9%. Petroleum sector, despite having huge potential, had been on the downside from 8.2% to 7% in a year.

Fig. 4: Share in Outstanding June 2010



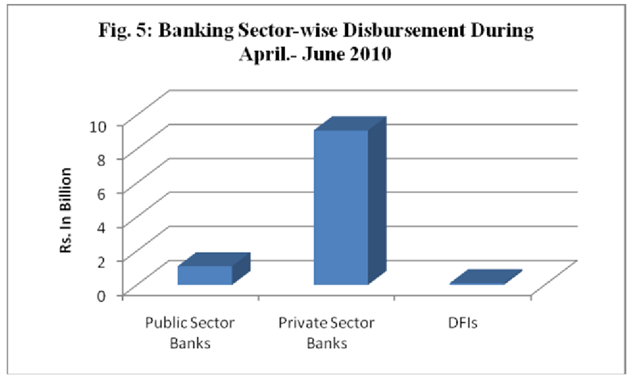
Share in Outstanding June 2009



Banking Sector-wise Performance:-

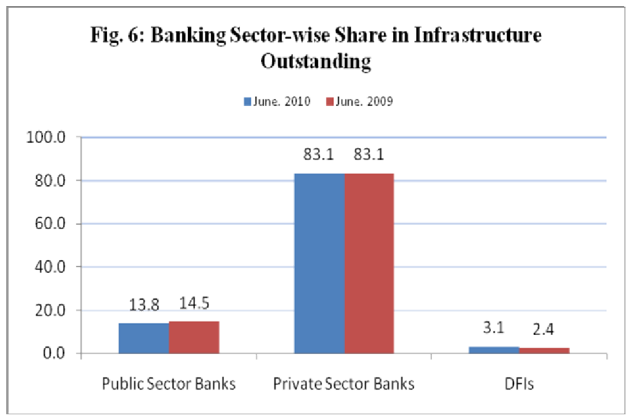
Banking Sector-wise Disbursements:-

Figure 5 shows private sector commercial banks have disbursed Rs. 9.05 billion (87.9%) out of total Rs. 10.3 billion financing in infrastructure sectors during the quarter. Public sector banks disbursed Rs. 1.07 billion (10.4%) while DFIs have miniscule Rs. 148 million (1.4%) despite having a mandate of development finance. In Mar-June 2009 quarter, private sector banks disbursed Rs. 20.5 billion (93.6%) while public sector banks and DFIs disbursed less than one billion.



Banking Sector-wise Share in Outstanding:

Figure 6 shows the category-wise share of banking sector in outstanding stock of infrastructure financing. The trend is predominantly in private sector banks' way. The stock share of private sector banks is hovering around 83% at the end of June 2010. Public sector banks slowed down a bit from 14.5% to 13.8% while DFI's didn't post any major shift during the year. Though private banks enjoy a major share, portfolio diversification beyond limited infrastructure sectors is highly desirable.



New Initiatives in the Quarter:

Only one new initiative was reported in this quarter in Ports & Shipping sector. This project is an expansion of container handling on port, which seeks an enhanced capacity of more than one million TEU (Twenty-foot equivalent unit) by the end of 2017 from existing 850,000 TEU. This project has the estimated cost of Rs 16.6 billion on a 63:37 debt equity ratio.

Major Departmental Initiatives and Achievements:

Appreciating the critical role of infrastructure sector in propelling the domestic economy, following key initiatives have been taken/planned by SBP to further develop market based mechanisms and enhance the flow of credit to this priority sector.

1. **Infrastructure Development and Financing Institution (IDFI):**

IHFD is pursuing a very significant objective of establishing a dedicated Infrastructure Development and Financing Institution (IDFI), with the blessings of Government of Pakistan. IDFI would be mandated with broad scope of identifying, developing, structuring and financing projects in key areas of infrastructure. Key multilaterals like World Bank, IFC, ADB and IDB are on board with keen interest to participate in the form of either technical assistance or financial participation. Negotiations with consultant are being finalized to prepare business model and feasibility report of IDFI, which is expected to be completed in second quarter of fiscal year 2010-11.

2. Capacity Building Program:

A comprehensive Training Program on Infrastructure Project Finance was conducted with the assistance of the World Bank Group from 12 to 16 July 2010 at SBP's Learning Resource Centre in Karachi. This was for the first time that such a high level massive training program on Infrastructure Project Finance was held in Pakistan. This SBP-World Bank joint initiative was taken to address the issue of lack of expertise in the financial sector on project development and financing. Cambridge Economic Policy Associates (CEPA), a very renowned organization for working in infrastructure development and training sector, prepared the course manual and delivered the training. Around sixty professionals associated with infrastructure development and financing from banks, DFIs and federal and provincial governments participated in the training program. IHFD will continue similar training program in different cities of Pakistan to spread international best practices and enhance the capacity building of financial institutions and infrastructure units and divisions of federal and provincial governments.

3. Revised Guidelines for Infrastructure Project Finance:

The issuance of revised guidelines for Infrastructure Project Finance is going through the process of approval and expected to be notified during second quarter of fiscal year 2010-11. The revised guidelines intend to facilitate the financial institutions to structure their lending mechanism in line with international best practices of assessing and mitigating risk inherent in large infrastructure projects.