‘July-September 2010’

Quarterly Infrastructure Finance Review

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Contents

List of Figures

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 regional countries 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 was hovering around Rs. 260 billon since last couple of quarters. This trend, however, changed in this quarter and the outstanding portfolio of infrastructure rose to Rs. 286 billion – a 10% increase from the previous quarter. The increase in outstanding portfolio does not present a rosy picture if we look beneath the surface a little further. The rise of Power Generation sector, which was in evidence persistently for quite some time, has further reinforced in this quarter as its portfolio has increased from Rs. 146.5 billion to Rs. 174.2 billion in this quarter. This increase of outstanding portfolio in Power Generation sector is contrasted with decrease in all other major infrastructure sectors. The scenario is persisting insomuch that only one sector is having any meaningful activity while other sectors are losing vigor. This is also true for the disbursement as 91% disbursement went to Power Generation sector. The volume of disbursement was Rs. 18.9 billion in the same quarter a year ago and it reduced to Rs. 7.9 billion in this quarter. The recurrent theme of successful international experiences is that the countries that excelled at infrastructure development first attained the capacity of developing viable projects and attracting private sector. The financing is not as much big issue as the capacity of developing viable projects. There is a dire need of institutional capacity to develop marketable projects in the diversified areas like road, mass transit, port and agri infrastructure etc. Total NPLs stood at Rs. 6.8 billion for this quarter while same were Rs. 4 billion during July-September 2009.

Outstanding Portfolio:

Total financing outstanding at close of September, 2010 was Rs. 286 billion against Rs. 260 billion at the end of previous quarter of June 2010. The volume of outstanding portfolio was Rs. 279.4 billion at the end of September 2009. The analysis shows, as in figure 1, 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 sector and demand of energy are the main reasons of its solid growth

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

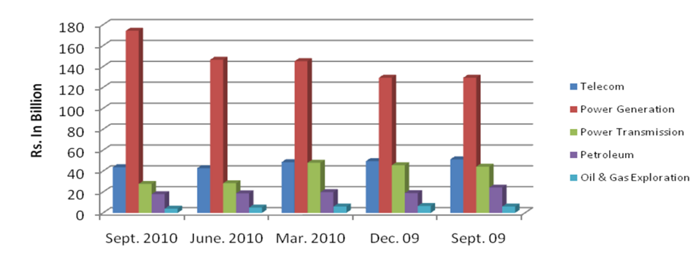
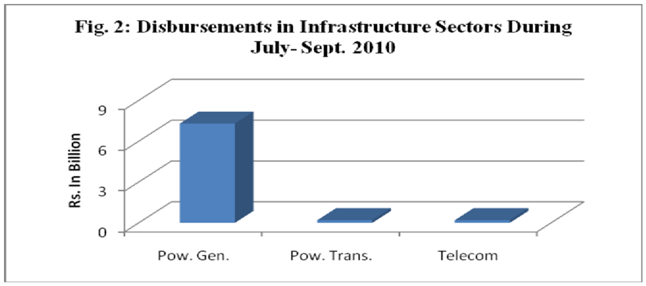
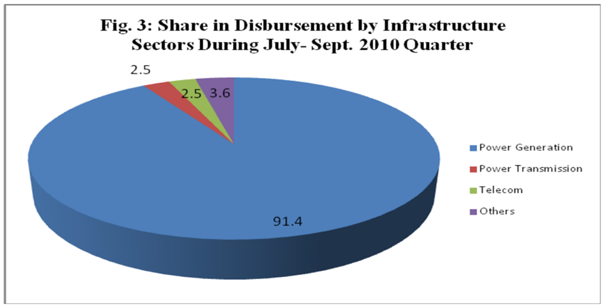


Figure 1 shows the quarterly position of top five sectors from September 2009 to September 2010. All the top five sectors, except Power Generation, are showing a decline in their respective volume of outstanding over the year. However, the steep decline was witnessed in Power Transmission and Distribution sector. The outstanding volume in this sector was Rs 44.2 billion at the end of September 2009 which reduced to Rs 27.7 billion at the end of the quarter under review.



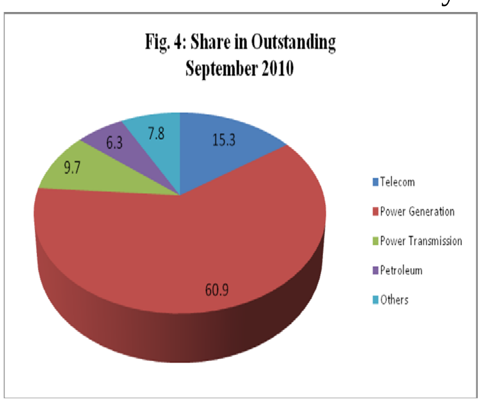
Disbursements:

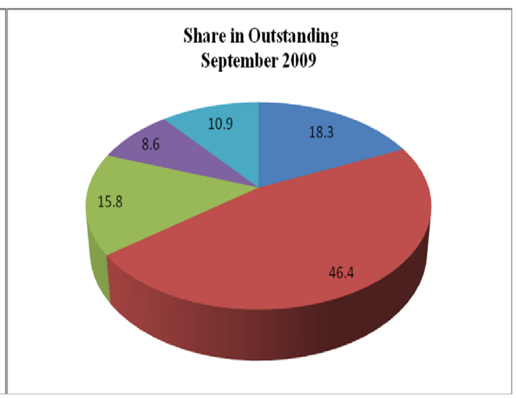
Total Rs. 7.9 billion were disbursed during July-September 2010 quarter in all infrastructure sectors against Rs. 10.3 billion in the previous quarter. The disbursement during July-September 2009 quarter was Rs. 18.9 billion. Figures 2 and 3 show the amounts disbursed and share of each sector during the quarter under review. Power generation sector received Rs. 7.2 billion, which is an overwhelming share of 91%. Share of power generation sector in disbursement was also significantly higher in previous quarter at 61.2% (Rs. 6.3 billion) whereas it was 69.8% (Rs. 13.2 billion) during July-September 2009 which shows that there was a relatively better diversified scenario in infrastructure sectors in previous quarters. Petroleum sector was conspicuous by its absence in this quarter while both Power Transmission and Telecom received only Rs. 200 million each 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.

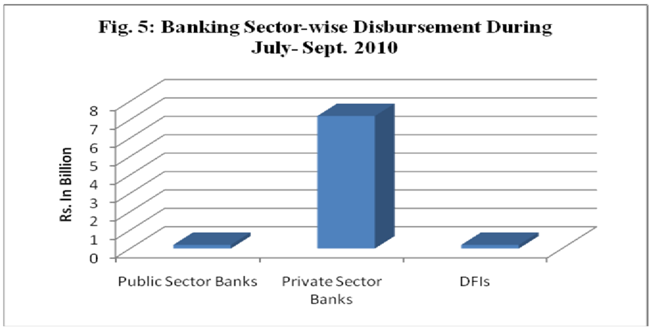


Analysis of Sectoral Share in Infrastructure Portfolio:

Figure 4 shows the comparison of top four sectors in outstanding infrastructure financing at the end of September 2009 with the status existing on September 30, 2010. At the end of September 2009, power generation sector had 46.4% of the total stock followed by telecommunication sector with 18.3%. After a year, the top slot continues to be held by power generation sector with a substantial 60.9% share in the pie. All other sectors in graph showed a declining trend. The Telecommunication sector remained at second place with 15.3% share followed by power transmission sector at 9.7%. Petroleum sector, despite having huge potential, had been on the downside from 8.6% to 6.3% in a year.







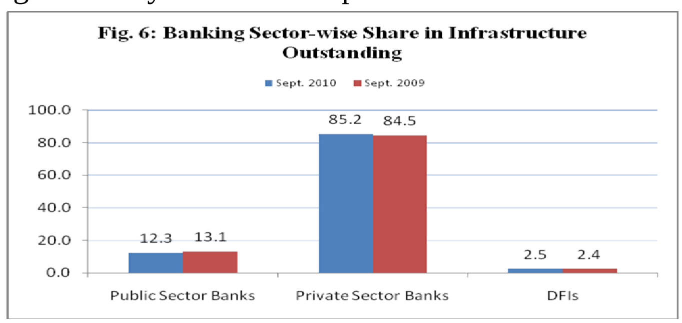
Banking Sector-wise Performance:-

Banking Sector-wise Disbursements:-

Figure 5 shows private sector commercial banks have disbursed Rs. 7.2 billion (91%) out of total Rs. 7.9 billion financing in infrastructure sectors during the quarter. Public sector banks disbursed Rs. 348 million (4.4%) while DFIs have Rs. 320 million (4%) despite having a mandate of development finance. In July-September 2009 quarter, private sector banks disbursed Rs. 15.9 billion (84.12%) while public sector banks disbursed Rs. 2.9 billion. DFIs' share in disbursements during the quarter July –September 2009 was a meager 1.8%.

Banking Sector-wise Share in Outstanding:

Figure 6 shows the category-wise share of banking sector in outstanding stock of infrastructure financing. The trend remains the same throughout the year. Share of private sector banks' rose from 84.5% to 85.2%, while share of public sector bank declined from 13.1% to 12.3% after a year. The share of DFIs remained more or less same through-out the year. Though private banks enjoy a major share, portfolio diversification beyond limited infrastructure sectors is highly desirable.



Major Departmental Initiatives and Achievements:

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

1. Revised Guidelines for Infrastructure Project Finance:

The department issued guidelines for infrastructure project finance. The new guidelines cover a broad array of concepts like project insurance, requirement of technical feasibility, risk assessment and allocation matrix, financing during development phase, emphasis on Operation & Maintenance Agreement for initial years, financial covenants, technical monitoring of projects during loan tenure and requirement of Supply and Off-take agreements.

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. IHFD has planned to continue this capacity building initiative in this business year with the help of local trainers. The next training program is scheduled in February 2011 and the venue will be Islamabad.