ECO Trade and Development Bank

Pakistan
Country Partnership Strategy
2017-2018

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I. Main Economic Indicators

Table 1: Basic Macroeconomic Indicators

	2012-13	2013-14	2014-15	2015-16	2016-17
Population (mid-year; mln)	182.5	186.2	189.9	193.5	197.2
Average exchange rate (PAK/ USD)	96.7	102.8	101.2	104.2	104.68
Inflation rate (CPI average; %)	7.4	8.6	4.5	2.9	4.16
GDP at current prices, (nat. currency bln)	22,378	25,068	27,383	29,102	31,862
GDP at current prices (USD, bln)	231	244	270	279	304
GDP / capita (in current. prices; USD)	1,333	1,383	1,512	1,530	1,629
Real GDP growth (%)	3.7	4.1	4.06	4.51	5.28
Unemployment rate (%)	6.2	6.0	5.9	N.A	N.A
Remittances, net (USD bln)	13.9	15.8	18.7	19.9	19.35
Direct foreign investment (USD bln)	1.5	1.7	0.92	2.3	2.7
Consolidated budget balance / GDP (%)	-8.2	-5.5	-5.3	-4.6	-5.8
Gross public debt / GDP (%)	64.0	63.5	63.3*	67.6*	67.2*
Total Government Debt/GDP (%)	60.2	58.1	58.3*	61.2*	61.6*
Exports (fob, USD bln)	24.8	25.1	24.1	21.9	21.9
Imports (fob USD bln)	40.2	41.8	41.3	41.2	48.5
Trade balance (exp. fob. - imp.fob.; USD bln)	-15.4	-16.7	-17.2	-19.3	-26.6
Current account balance (USD bln)	-2.5	-3.1	-2.7	-4.8	-12.4
Current account / GDP (%)	-1.1	-1.3	-1.0	-1.7	-4.09
Official reserves (eop; USD bln)	11	14.1	18.7	22.05	23.09

(*) Provisional,

Sources: SBP, PBS & MoF

II. Economic Overview and Outlook

Real Sector

Pakistan's economy recorded a growth rate of 4.5% in fiscal year 2015-2016 (FY16), against a target growth rate of 5.5%, which was the highest rate achieved in the last eight years. The growth was mainly supported by services and industrial sectors of the economy. The economy was not able to achieve the target growth rate as per the Annual Plan due to agriculture sector undershooting its respective target.

In 2016-2017 (FY17) the growth rate for the economy was recorded at 5.28%. Growth was broad based with industrial, services and agriculture sector posting positive growth rates. A stable macroeconomic backdrop, supportive economic policies and significant improvements on energy and security front also acted as impetus to the underlying economic growth.

The industrial sector which accounts for 20.8% share in GDP recorded a growth rate of 5.02% in FY17 compared to of 5.8% last year. Large scale manufacturing grew at rate of 4.6% against 3.29% percent last year. This sector is expected to post further growth in the near future as the investments under the China-Pakistan Economic Corridor (CPEC) are realized. Government of Pakistan has decided to set up 29 special economic zones under CPEC which are expected to attract FDI, promote industrialization, expand export base, and competitiveness.

The services sector which accounts for 59.6% share of GDP posted a growth of 5.98% in FY16 compared to 5.5% recorded last year. The share of services sector in overall GDP stood at 59.2%. The underlying growth was mainly attributed to wholesale and retail trade which grew by 6.8%.

The agriculture sector which accounts for 19.53% share in GDP turned around and recorded growth rate of 3.5% as against subdued 0.27% growth recorded in FY16. The rebound witnessed was on account of supportive agriculture policy of government, introduction of relief measure and increased credit disbursement to the sector.

External Sector

The continuing slow and uneven recovery in major developed countries and moderate growth in developing countries have led to sluggish trade growth in Pakistan in the past several years. Exports decreased in FY16 and stood at USD 21.9 billion compared to USD 24.1 billion recorded last year. Imports decreased slightly to USD 41.2 billion in FY16 from USD 41.3 billion recorded last year. Resultantly, the trade deficit increased to USD 19.3 billion compared to USD 17.2 billion recorded last year.

In FY17 exports stood at USD 21.9 billion which was similar to the value recorded in the comparable fiscal period last year. Imports rose to USD 48.5 billion versus USD 41.2 billion recorded in the comparable period last year. Resultantly, the trade deficit increased to USD 26.6 billion compared to USD 19.3 billion recorded last year.

The current account deficit deteriorated in FY16 to USD 4.8 billion from USD 2.7 billion recorded last year. In terms of GDP current account deficit stood at 1.7% compared to 1.0% in comparable period last year. In FY17 current account deficit increased to USD 12.40 billion compared to 4.8 billion recorded last year and in terms of GDP stood at 4.09%.

Fiscal Outlook

In FY16 overall fiscal deficit decreased to 4.6% of GDP against a target of 4.3%. Fiscal deficit has shown a declining trend over the last four years. However, in FY17 fiscal deficit rose to 5.8% as expenditures outpaced revenues.

Gross public debt to GDP ratio rose to 67.6% in FY16 from 63.3% recorded last year based on provisional data. Public external debt to GDP ratio rose to 20.4% in FY16 from 18.9% recorded last year. Gross public debt increased as a result of revaluation losses, increase in borrowing from IFIs and budgetary borrowing over and above the budgetary requirements from banks. In FY17 based on provisional data gross public debt to GDP ratio slightly decreased to 67.2%.

Monetary Policy and Inflation

The consumer price inflation has been on a downward trajectory since the start of the FY15. A broadly stable exchange rate, reduced reliance of government budgetary borrowing from central bank, and positive global commodity price developments helped keep inflationary pressures low in the country.

SBP continued with monetary easing in FY16 and delivered two interest rate cuts of 50 bps and 25 bps and as result brought the policy rate to a low of 5.75%. Headline inflation was recorded at 2.9% in FY16 which was significantly lower than 4.5% recorded last year underpinned by prevalence of low oil prices globally. In FY17 inflationary pressures built up due to uptick in domestic demand as economic activity picked up and revival observed in international commodity and oil prices. Average inflation for FY17 stood at 4.16%. SBP maintained its monetary policy stance in FY17 and policy rate was kept at 5.75%.

Future Outlook

Economic growth outlook for Pakistan looks favorable and over the medium-term real GDP growth is projected to equal 6% underpinned by the CPEC related investments, better energy supply and growth supporting structural reforms. The recent uptick witnessed in private sector credit, expected second-round effects from improved infrastructure and better availability of energy, improved security environment and recovery in exports suggest that economy is on an upward trajectory.

III. Review of Bank's Operations

The Bank's operations have been growing in Pakistan across following means i.e. lending through financial intermediaries, project and corporate finance loans. From the beginning of operations in 2008, the total disbursement of the Bank to various operations in Pakistan amounted to USD 463.4 million by the end of September 2017. In addition, undisbursed commitments of USD 2.6 million will be released according to performance of the active operations. The Bank's total outstanding portfolio in Pakistan was USD 131.4 million as of end-September 2017.

The Bank has been working with selected local financial intermediaries in Pakistan where such delegation of responsibility assists the Bank in serving a targeted market segment more efficiently and effectively than the Bank might be able to do directly. The liberalized financial institutional and formation of privately held banks provide a conducive environment for a thriving intermediary business.

In Pakistan, supporting expansion of the financial sector and improving financial inclusion is important in enhancing credit flow to development of real sector and alleviate poverty as well. Efforts are made to encourage financial institutions to provide support to real sector investments and development of SMEs, micro-enterprises, rural areas. Particularly, microfinance has huge potential in the country for generating employment opportunities and reducing poverty. Pakistan is one of the few countries in the world that has a separate legal and regulatory framework for microfinance banks and enjoys the number three position in the world in terms of microfinance business environment. The SBP has been taking significant steps to promote the growth of the microfinance sector. Therefore, through micro-finance banks, the Bank will focus on expanding access to finance, particularly among lower-income groups and micro-enterprises. In line with the Pakistan's poverty reduction strategy, the Bank would also cooperate and provide support to relevant programs that focus on community empowerment. The Bank would also enhance its guarantee facilities as one of the most complementary instruments to its credit operations in order to stimulate trade finance and investment in Pakistan.

In order to improve its disbursement positions vis-à-vis Pakistani banks, in the ensuing period the Bank would focus more on mid-tier banks, microfinance banks and evaluate financially sound institutions in order to add them to its list of approved FIs. Furthermore, the economic situation is now gaining further momentum and it's expected that private sector credit from the larger banks would also increase in near future making them more receptive towards ETDB's financing facilities.

In the forthcoming period, the Bank will give due consideration to identification of bankable projects and increasing its operations in Pakistan. Broadly defined, operations would be directed towards supporting the financial sector, M-SMEs, trade finance, corporate sector and development of production infrastructure.

(i) Micro-Small and Medium Sized Enterprises (M-SMEs) Development Facility

Under this program the Bank offer loans to various financial institutions which subsequently on-lend to the Micro and SMEs. This facility is designed in a manner where the Bank risk is on the financial institutions and their expertise to on lend to SME Sector of the country. SME facility plays a vital role in creating jobs and generating income for low income people. It also serves the ETDB mandate in an optimal manner.

The Bank is seeking co-funding from the participating financial institution in each on-lending, in order to strengthen the relationship between the intermediary and its clients, and to increase the intermediary's interest in the good performance of the credit line. The main goal of these intermediated loans is to support growth and employment potential of the SMEs. The Bank has specific eligibility criteria which are defined to the selected Financial Institution in order to assure that funds are moving to the Bank's target market. Funds will be allocated to M-SMEs according to following amounts and requirements.

Client Category	**Micro**	**SME**
Headcount	**<50**	**51-250**
Annual Turnover	**<EUR 50,000.-**	**EUR 51,000-EUR 15,000,000**

a) Only be applied to SMEs which are bankable, financially sound and will be able to use the funds economically.
b) Only be applied to finance of SMEs domiciled in the territory of the ETDB member states.
c) Only be used by SMEs which comply with ETDB rules on sector eligibility and restrictions as defined in this document.

In addition to above final beneficiaries of the SME development loan will be filtered according to the negative list of products, sectors and the environmental policy of the Bank. The SMEs comprise 85 percent of entrepreneurial businesses in Pakistan, employ approximately 78 percent of the non-agricultural labor force and contribute over 25 percent of the country's exports of manufactured goods. Therefore, promoting the production and innovation capacity of vibrant SMEs in Pakistan remains a priority for the Bank. The Bank total disbursement for M-SMEs loans since 2008 has been amounted to USD 62.5 million by the end of September 2017. The SMEs that benefitted from these funds were mainly active in the manufacturing, trade, agriculture and services sectors, thereby contributing to the economic development of the country and job creation.

In 2014 ETDB initiated microfinance lending in Pakistan. This was the first international loan facility to a microfinance institution in Pakistan. The Bank was able to disburse funds to a leading Microfinance Bank which worked mainly for agriculture financing to small farmers. Small farmers are mainly people from the low income group or the population which resides below the poverty line. As the loan size to an individual farmer was small, the overall impact in the region was phenomenal. The microfinance bank was able to disburse the loan to approx. 19,200 farmers out of which 80% loan is given for agriculture financing.

In the coming years, the Bank will continue to cooperate with further local financial institution for the benefit of the flourishing entrepreneurial activities in Pakistan. In this respect, the operation with partner institutions will improve the conditions offered to the end-beneficiaries in order to support the SMEs.

For the last couple of years, certain factors resulted in sub-optimal uptake of Bank's SME funds by the partner financial institutions. Firstly, tough economic conditions, energy shortages and security situation in Pakistan took its toll on businesses which led to increasing ratios of non-performing loans in the portfolio of large banks making them scale back their SME operations.

Secondly, the large deposit base of some financial institutions gave them access to sizeable amounts of liquidity at very low prices.

Microfinance sector players are microfinance banks (MBs) and microfinance institutions (MFIs). Microfinance banks (MBs) are well regulated under State Bank of Pakistan. Though microfinance institutions (MFIs) are not regulated under State Bank of Pakistan, but they have tightened their regulation. ETDB will initially observe their performance before initiating a relationship with MFIs. ETDB will continue to support MBs in Pakistan and if regulatory framework improves, the scope of the Bank's microfinance development facilities would also include MFIs in Pakistan.

(ii) Short Term Trade Finance (STTF) Program

Trade finance is a distinct core business of the Bank. The program has been designed to strengthen the ability of local banks to provide trade financing to entrepreneurs throughout the country to expand their import and export trade activities.

The FIs participating in the program have been making use of relevant products offered under the STTF and have helped a number of businesspersons in their trade transactions within and outside of the region. Each and every transaction is filtered according to the negative list of products and the environmental policy of the Bank.

Since the beginning of the program in 2008, the Bank disbursed a total amount of USD 156.1 million in Pakistan by the end of September 2017. There are two reasons behind the sub-optimal utilization of the STTF facilities by Pakistani partner financial institutions:

i. The availability of alternative and concessional financing window available to the Pakistani banks from the State Bank of Pakistan for export financing dampened their eagerness for ETDB funds.
ii. High liquidity due to low cost domestic funding eliminates the need for international funding

The Bank will continue to seek new opportunities to provide short and medium term trade financing to eligible partner banks for trade finance purpose and to the companies for trade transactions under its Trade Finance Program. Priority will be given to export finance and for import finance, energy sector related importation of capital and intermediary goods will be promoted.

(iii) Corporate and Project Finance

The Bank will continue to provide its assistance in fostering economic development and social progress in Pakistan by providing medium to long term corporate and project finance to businesses and development projects. The process of selecting projects is based on the assessment of additionality and development impact. Contribution to national priorities and promoting complementarities among member states will be the preferential factor in allocation of funds towards projects with the optimum risk/return ratio. The corporate loans are provided to firms and public sector entities in order to cover their needs such as acquisition of equipment, modernization of plant and structures, trade transactions and other related expenditures. As a result of sustained focus towards disbursements, since 2008, the total disbursements under corporate and project finance operations in Pakistan have increased to USD 244.8 million by the end of September 2017.

Continuing the bank's focus towards power sector of the member state, the bank approved a project finance of USD 8.221.350 for a solar power project, (Harappa Solar Power). The project documents have been signed in February 2017 for tenure of 10 years 9 months, including 9 months' grace period for construction. The Bank co-financed the operation along with two local banks namely BOP and Askari Bank.

As a further testimony to the bank's commitment towards the member state's energy requirements, a trade finance facility of USD 40 million was disbursed in February 2017 to contribute towards the government's endeavors to maintain a steady flow of oil imports. This short term loan has been disbursed through the Ministry of Finance, Government of Pakistan.

As for the existing portfolio, the outstanding project finances to Zorlu Enerji and the soft loan to the Government of Pakistan for Flood relief continued to be serviced satisfactorily, with achievement of the desired objectives in the form of respective capacities coming online as envisaged.

On the basis of the experience being gained in the country, the Bank is putting efforts to identify projects that would have maximum impact. In this respect, efforts are intensified to such projects that contribute to development of renewable energy resources, infrastructure and manufacturing, seeking to increase the coverage and effectiveness of such projects to sustain energy supply and development of real sectors.

IV. Conclusion

Pakistan holds enormous potential for economic growth. Since 2013-14, the economy has witnessed a smooth upward trend in growth rate. Real GDP growth was above four percent in 2013-14 and has smoothly increased during the last four years to reach 5.2 percent in 2016-17, which is the highest in 10 years. The accommodative monetary policy stance, increase in development spending, substantial growth in private sector credit, inspired activities in the power sector, friendly and pro-growth policies for real sector growth, such as relief measures and in particular for the agriculture sector, were instrumental in achieving this impressive growth performance.

The overall performance of the banking sector remained robust during the last couple of years. The alignment of the regulatory capital requirements in Pakistan with best international practices coupled with high profitability has helped achieving strong solvency. The Capital Adequacy Ratio (CAR) of 16.2 percent as of end December 2016 is much stronger and higher than the minimum required level of 10.6 percent. A stable exchange rate, and the fact that the government passed on the benefits of lower global oil prices to domestic consumers, not only softened inflationary expectations but also pulled down headline CPI inflation to a decade-low. The impact of these factors was strengthened by growth in proceeds from privatization. Given these positive developments, the broad based growth is expected to continue in Pakistan.

The country's outlook is brightened and looks promising on the back of agricultural recovery, rebound in industrial activities and inflow of investment under China-Pakistan Economic Corridor (CPEC). The Bank will pursue its operations during the coming period in order to contribute to Pakistan's development strategy and objectives keeping in perspective the Vision 2025 and framework for 11th Five Year Plan (2013-18). The Bank would also consider priorities envisaged in the Public Sector Development Programs (PSDP) and the Annual Plans. The Vision 2025 is the roadmap for achieving balanced human, physical, social, and economic development that is inclusive and sustainable.

To achieve the goals set in the Vision, projects falling under the purview of the seven pillars have been initiated, which include integrated energy, modernizing infrastructure, institutional reforms in the public sector, value-addition in the commodity producing sectors, exports promotion, water and food security, private sector led growth and promoting entrepreneurship. In addition to these seven pillars, Vision 2025 identifies five key enablers, which are critical for success of the plan, namely; political stability, peace & security, rule of law, shared vision and social justice. Accordingly, the Vision aims to transform Pakistan into a self-reliant and prosperous nation by 2025.

To this end, this country strategy document is the primary analytical and planning tool that would enable ETDB to design, execute, monitor, review, and evaluate its operations in Pakistan. The Bank's role and priorities are defined according to (i) country development priorities and (ii) available resources, strategies and policies of ETDB. Within this perspective, the Bank will continue to focus on providing support to strengthen competitiveness and resilience of the economy and transform Pakistan into a dynamic emerging market economy.

The Bank will consider undertaking activities and providing services which may advance its purpose, paying special attention to activities promoting export of goods and services and development of infrastructure in co-operation with the private sector. In addition, through selected intermediaries, the Bank would attempt to expand its financing programs in favor of M-SMEs. The Bank would also put efforts to directly cater to financing needs of medium sized enterprises which would promote modernization of equipment and improvement of products and services. Promoting innovation and entrepreneurship would be the cornerstone of Bank's facilitation to private sector. Particularly, providing support to the exporting companies would help to improve competitiveness and content of value added in exports. The Bank will also continue to seek opportunities for co-operation with a variety of other lenders including multilateral development banks, bilateral financial institutions, export-credit agencies, official lenders or guarantors, commercial banks, and other financial intermediaries. In the coming period, the major components of the country program would include:

Financial sector. Support growth in financial access and assist development of services and products of local financial institutions in SMEs finance, trade finance, microfinance, Islamic finance and leasing.

Energy. Promoting integrated energy development to increase energy security and efficiency. Support development of hydropower, clean coal-based power plants and renewable energy potentials. Promotion of energy efficiency across selected sectors of the economy particularly in manufacturing sector. Development of storage and transport facilities with emphasis on cross-border interconnections.

Infrastructure. Investments to improve transportation, education, health, technological research and communication technologies. Enhance public–private partnerships. Support urbanization as an important driver of growth. Engage in development of efficient transport system particularly through the National Trade Corridor program.

Manufacturing. The Bank will support local corporations to fund their needs with a focus on development of entrepreneurship, productivity, innovation, efficiency, capacity building, technological up-gradation and R&D leading to higher value added output.

Agriculture. The operations will focus to infrastructure development, water management and productivity. Emphasis will be given for improving and value addition to the produce of agriculture sector and allied sub-sectors to accelerate agriculture growth for reducing rural poverty, achieving self-reliance in essential food commodities, as well as expansion of exportable surplus and galvanizing agro-business potential. Promoting mechanization, storage facilities, packing, certification and marketing system would be targeted.

Trade. Support expansion & diversification of trade in terms of markets and products with an aim to contribute the target of Pakistan to boost exports to USD 150 billion by the end of 2025.