



الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

ECONOMIC & BANKING SECTOR OVERVIEW

**Islamic Republic of
Pakistan**

July, 2020

ECONOMIC OVERVIEW

With a population base of about 205mn, Pakistan is the world's 6th most populous nation. Pakistan is classified as "lower middle-income earning²" by the World Bank given its gross national income ("GNI") per capita ranging between US\$1,300 -US\$1,400.

In the fiscal period ended June 2019, Pakistan's economy registered expansion at 3.3%, albeit at a slower pace than prior

periods due to weak performance of commodity producing sector with carryover impact on the services sector. Given the wide twin deficits, the government had been on the course of implementing both fiscal and monetary policy reforms including realignment of exchange rate, tightening interest rates, increasing energy prices and curtailment of public sector development expenditure. However, government's policy actions did not translate into better fiscal imbalance due to shortfall in revenues and higher interest payments.

During H1'FY2019-2020, notable improvement was noted in economic activity. Current account deficit posted some improvement due to import compression and higher remittance inflows from previous fiscal period. During H1' FY2019-2020, Pakistan's current account deficit reduced to six-year low levels. As per World Bank, Pakistan's current account deficit further narrowed during July'2019 to February 2020 to 1% vis-a-vis 3.5% in the corresponding prior year period.

However, global spill-over effects of Covid-19 and containment measures may severely contract the output in H2'FY2019-2020, also putting further pressure on public finances. While lower oil prices may bode well for Pakistan's economy in terms of possibly favorable foreign trade balance, lower external demand, weak remittance inflows may have more than off setting adverse impact on balance of payments.

Pakistani Rupee ("PKR") maintained its downward trajectory vis-a-vis US\$, continuing to depreciate in double digits over the last two years and having weakened by about 10.4% at end-2019, and further by about 3.5% until May 18, 2020.

Total official reserves including foreign exchange held by banks stood at US\$14.5bn as at end of FY2018/2019 (i.e. June 2019), further having grown to US\$17.9bn at December 2019 (US\$18.7bn on May 8, 2020). SBP's foreign exchange reserves had risen during 2019 with the disbursement of the 1st tranche of IMF's Extended Fund Facility and influx of foreign investment in domestic T-bills. Furthermore, in April 2020 the IMF approved the disbursement of US\$1.386bn under the Rapid Financing Instrument to meet the urgent balance of payment needs with the expectation of sharp decline in exports and inward remittances due to the Covid-19 outbreak.

Towards the end of Q3'FY2020 (i.e. Q1'20) to counter Covid-19 crisis Pakistan government rolled out PKR1.2tr fiscal stimulus package, equating to 1.2% of GDP. This was to target support low-income households, SMEs, construction sector and to boost the health and disaster response capabilities. This was in addition to a supplementary grant of PKR100bn for residual / emergency relief fund. For non-banking financial companies ("NBFC"), the Securities and Exchange Commission of Pakistan ("SECP") has announced one-year loan repayment deferral by customers .

%, unless otherwise stated	FY ¹ 2016/2017 A	FY 2017/2018 A	FY 2018/2019 A	H1' FY2019/2020 A
Population (million)	197	201	205	N.A.
GDP Per Capita (US\$; Current)	1,368	1,467	1,473	N.A.
Real GDP growth (%)	5.6%	5.8%	3.3%	N.A.
Inflation (CPI Average, %)	4.2%	3.9%	6.8%	11.1%
Current Account Balance as % of GDP	-4.1%	-6.3%	-4.8%	N.A.
Fiscal Balance as % of GDP [^]	-5.8%	-6.6%	-8.9%	-2.3%
Gross Public Debt as a % of GDP	67.0%	72.1%	84.8%	80.8%
Total debt as % of GDP	75.4%	82.1%	97.9%	88.7%

¹ Fiscal period starting July 1

² Country income classifications for World Bank's 2020 fiscal year: Starting July 1, 2019, new thresholds for "lower-middle income" based on GNI per capita (current) ranges between US\$1,026-US\$3,995

In addition, State Bank of Pakistan (“SBP” or “The Central bank of Pakistan”) announced certain measures to alleviate liquidity and FX pressure. Policy rates have also been eased after having tightened the monetary policy nine times by a cumulative 775 basis points (“bps”). Since the beginning of 2018 through January 2020, the SBP commenced easing in March, April and May 2020 and four policy rate cuts cumulating 525bps to 8% were effected to alleviate the recessionary impact of COVID-19.

PAKISTAN ISLAMIC BANKING

As of 2019, Pakistan’s banking sector comprised 33 banks³, of which 22 offer Islamic banking (“IB”) services (5 full-fledged Islamic banks and 17 operating as Islamic windows of conventional banks). Islamic banking segment accounts for 16.6% and 14.9%⁴ of the total banking industry deposits and assets, respectively, as of end-2019. With continued pace of deposit mobilization, IB segment deposits grew by 20% during 2019. Aggregate capital adequacy for the overall and IB sector has also improved on a timeline to 17% and 15.4%, respectively, as at end-2019 (end-2018: 16.2%; 14%, respectively). Due to the tough existing macroeconomic environment, gross non-performing financings ratio has increased over corresponding prior year period and stood at 8.6% and 4.3%, respectively for overall banking and IB at end-2019 (end-2018: 8.0%, 2.4%, respectively). With lower provisioning coverage at 54% at end-2019 vis-à-vis 83.2% at prior year, it may be notable that for IB, net NPLs in relation to total capital substantially increased in 2019 to 14.6% vis-à-vis 3.7% at end-2018. For the overall banking sector weakness in this metrics was relatively moderate on a timeline at 8.9% at end-2019 (end-2018: 7.8%). Annualized profitability in terms of return ratios, for both overall banking sector and IB segment edged up in 2019.

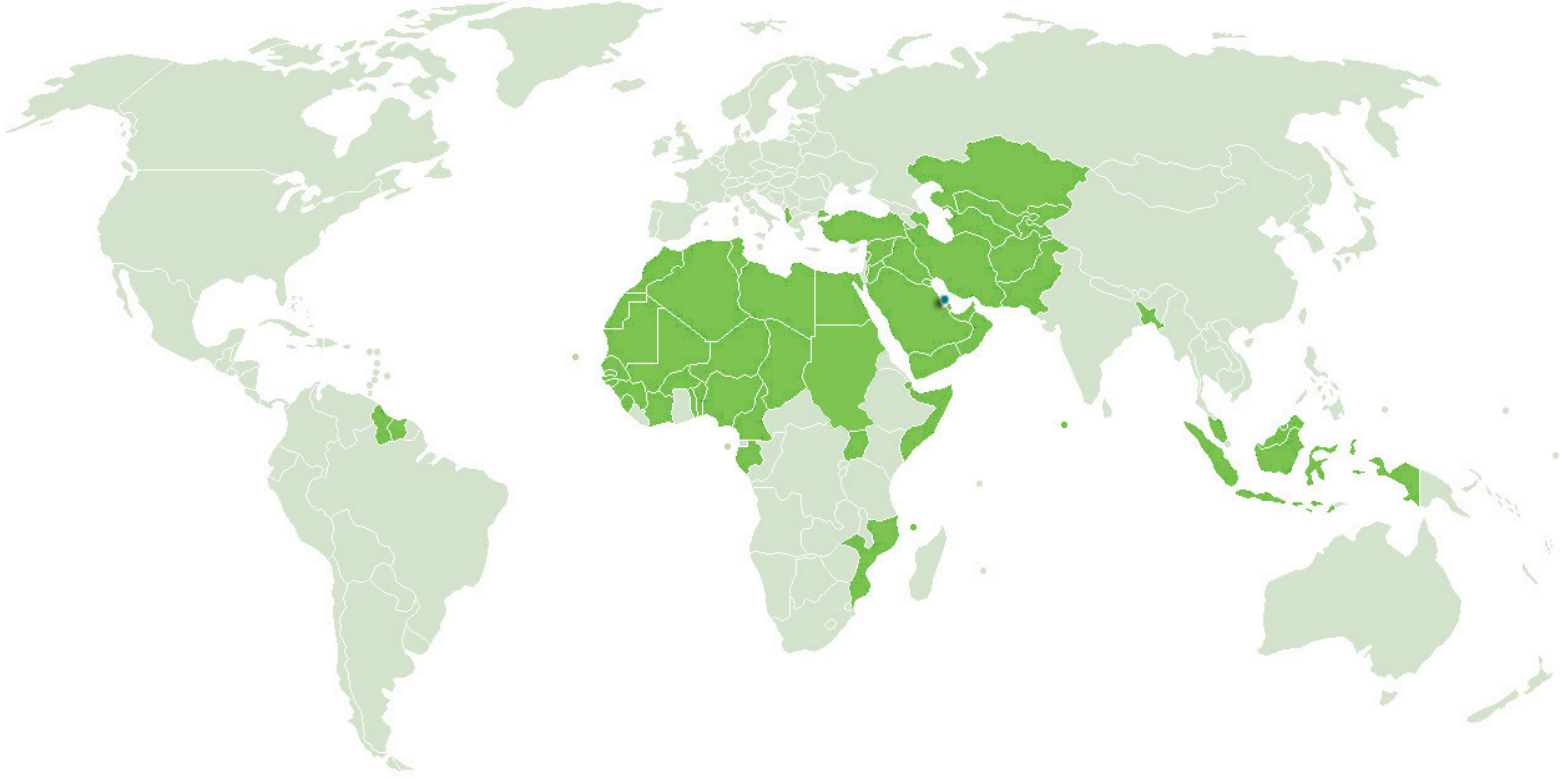
In addition to rate cuts, SBP has also announced temporary measures for the banking sector to provide some cushion until the interim quarters of 2020;

- Concessional financing by SBP to banks for financing purchase of equipment for Covid-19 treatment until September 2020
- Concessional financing for 3 months (April-June) to companies that do not lay off workers
- Banking sector to also allow one-year extension in principal repayment for one year, subject to receiving written request before end-June 2020
- Temporary refinancing scheme provided by SBP to banks to provide credit to manufacturing sectors until end-March 2021
- Regulatory credit limit for SME segment financing has been permanently increased to PKR180mn from PKR125mn
- Relaxation of debt-burden ratio for consumer loans from 50% to 60%
- doubling of the period for the rescheduling of loans from 90 to 180 days
- Capital Conservation Buffer (“CCB”) requirement has been temporarily reduced to 1.5% from 2.5%

Covid-19 may pose significant challenges for Pakistani banking sector. In the wake of COVID-19, we expect non-performance to rise across the sector with export based industries to be hardest hit and as commodity prices slump.

³ SBP: Quarterly Compendium: Banking Statistics – December 2019

⁴ SBP: Islamic Banking Bulletin: January-March 2019



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