



الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

ECONOMIC & BANKING SECTOR OVERVIEW

**Islamic Republic
of Pakistan**

December, 2016

The overall economic and fiscal indicators, both actual and forward-looking, generally seem to continue trending in a positive direction for Pakistan, with gradually improving economic growth, reduced inflation, improving fiscal deficit buoyed by lower oil prices, prudent monetary policies, fiscal consolidation and ongoing structural reforms. We still believe any further improvement in the country's macroeconomic situation primarily depends on the government's ability to implement a sound governance framework so as to maintain law and order situation, and constrain the adverse effects of an ineffective bureaucracy.

Increased construction activity, improving private sector credit growth, investment uptick due to China-Pakistan Economic Corridor projects and the 3-year IMF fund support arrangement, have all contributed to the real GDP growing to about 4.7% in FY2016¹ and further continue to grow to 5% in the next fiscal period (as against the central government's expectation of 5.7%). Likewise the lower oil and food prices and prudent monetary policy stance by SBP have aided in containing the inflation at sub-3% levels during the fiscal period - a significant improvement over prior periods (FY2015: 4.5%; FY2014: 8.6%). Nonetheless, it is also expected to increase to about 5% in line with economic growth. Sustained efforts in the tax policy and administration reforms coupled with the reduced energy subsidies have resulted in 4.6% fiscal deficit in FY2016, gradually improving from 5.4% a year ago (expected to further improve to 3.8% in FY2017). Gross international reserves have been built-up steadily almost tripling from FY2013 levels to US\$18bn; however these are still just manageable given these are expected to cover only about 4 months of imports. Still high and consistently increasing aggregate debt levels (including external debt @ ~92.6% of GDP), slip in the country's ranking² by 2 points to 138 in 2016 (and further to 144 in 2017) and security risks reflecting slower pace of reforms, somewhat temper the above stated positives. Nonetheless, we believe effective implementation of initiatives including restructuring of loss-making public sector enterprises and continuing energy and gas sector reforms, will further improve the prospects for the economy. The most recent inclusion of the country's equity index in emerging markets by MSCI also supports our above views.

Banking Sector

Pakistan's banking sector comprises 35 banks³, of which 21 are Islamic banking (IB) institutions (5 full-fledged Islamic banks and 16 conventional banks having standalone Islamic banking branches) presently. Islamic banking segment accounts for 13.2% and 11.4%⁴ of the total industry deposits and assets, respectively. Starting 2015, the IB in Pakistan has entered a phase of consolidation⁵. As witnessed earlier, Islamic banking assets grew at 28% year-over-year in 2015, continuing to outpace the overall banking sector (up 17%). While the return indicators for the overall banking sector remain stressed due to the monetary easing by SBP, we believe it will provide impetus to the private sector credit. As such, IB financing remains concentrated towards the corporate sector (excluding SME) at 78.1% in H1'16, higher than the overall banking industry average of 67.1%. Likewise, more than 90% of the overall banking sector investment comprises government securities, increasing the associated sovereign risk. However, it is currently somewhat mitigated by the improving economic prospects of Pakistan.

Note: All figures sourced from the IMF country report, dated Oct. 2016

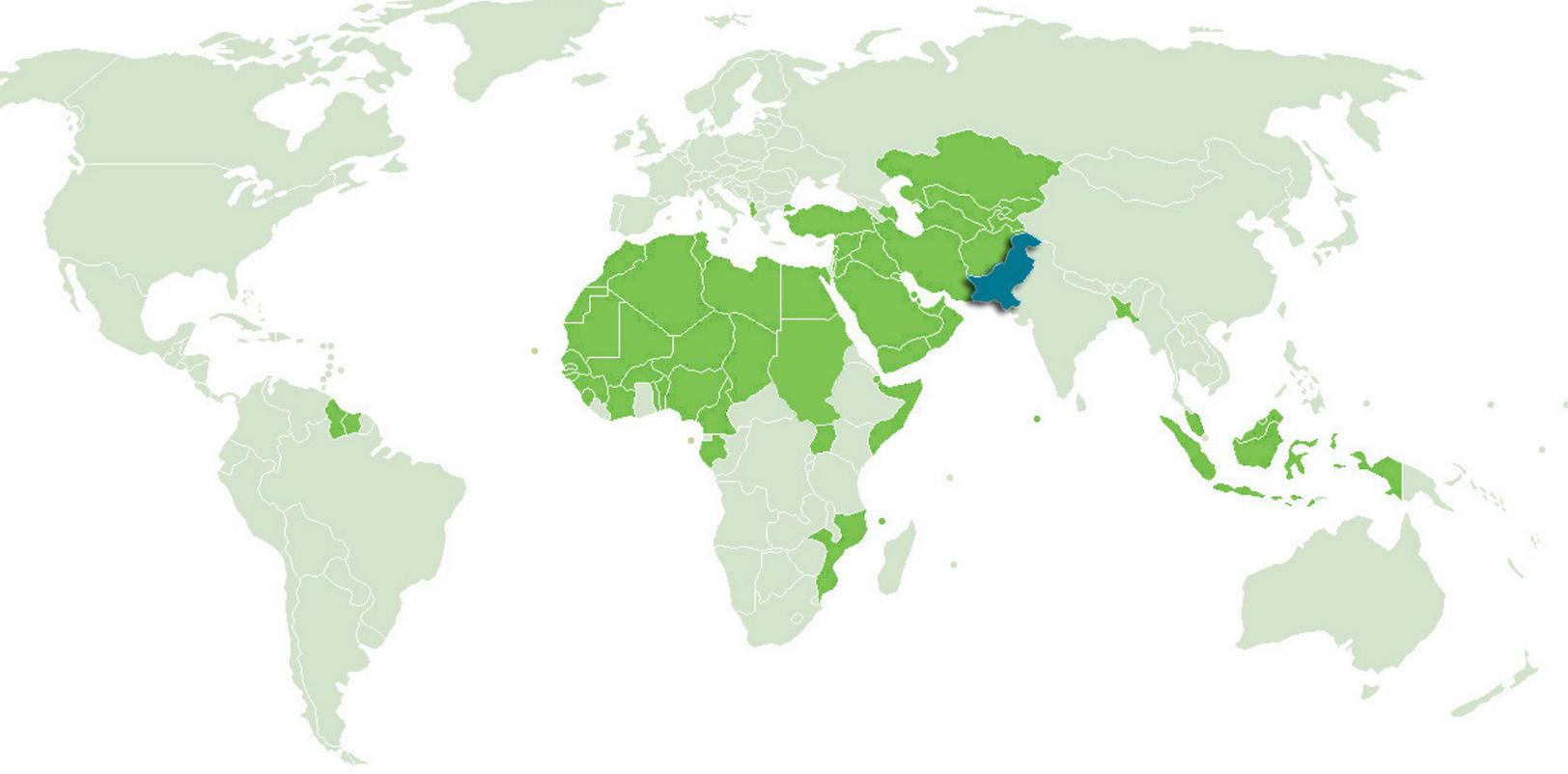
¹ Fiscal year ending June 30

² World Bank Doing Business Database 2016

³ SBP: Quarterly performance review of the banking sector, Jun. 2016

⁴ SBP: Islamic Banking Bulletin April-June 2016 and October-December 2015

⁵ 2015: Bank Islami Pakistan Limited acquired operations of KASB Bank Limited and Meezan Bank Limited acquired HSBC Oman's (S.A.O.G) Pakistani branches; 2016: BBL being consolidated with ABPL



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