CFA ASSOCIATION PAKISTAN

Vol 4 Issue 1 Sept 2009

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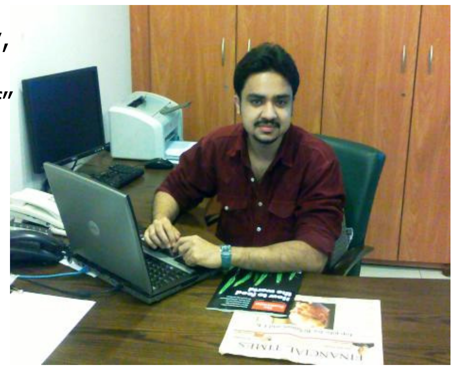
Editor's Message



"In order to conserve energy, the light at the end of the tunnel has been switched off" read one of my forwarded emails. Self-fulfilling prophesies of perpetual pessimism is a bigger culprit than anything else in this seemingly godforsaken country.

To stimulate some positivity amidst all this gloom we asked Mr. Ali Raza, President of National Bank to share his views on Pakistan's economy in our latest issue of CFAAP's Newsletter. For more avid readers we include an article on economy by Mr. Raza Khan Niazi of Invisor.

Not a very eventful quarter for the society this time around. A seminar on GIPS was held at Marriot Hotel in Karachi, which despite being the wrong day (weather-wise) was attended by a respected number of members. CFAAP, nevertheless, looks forward to an exciting quarter ahead with the mega Charter Award Ceremony, Career Day 2010, GIRC and a Networking event already hitting our 'to-do' list (see page 4 for details).

Members would also be pleased to learn about the more subtle developments taking place in the society. The Newsletter design and contents are revised after receiving a lot of helpful comments from our readers. CFAAP website is also undergoing substantial changes and we are hopeful that viewers will now find the site more user-friendly. The society is also expanding its presence on Facebook, where we plan to run active discussions on the hottest topics of members' interest .

A new look to our newsletter reflects on the changing moods of our audience. We have grown from a body of 71 members to 166 in matter of 5 years and by mid of next year the number is expected to reach above 200. With more young people making it to the member's list we decide to tone up the soberness found in our issues, publishing some serious work from renowned investment professionals alongside the usual more happening occurrences. We are open to your suggestions nonetheless. Happy reading!

Kamran Aziz

Wanted!

Want to give back something to the industry that supports us all?

Get involved with the CFA Society of Pakistan as a volunteer.

Learn how you can get help and get involved, contact Uroosa Girami at info@pakistan.cfasociety.org

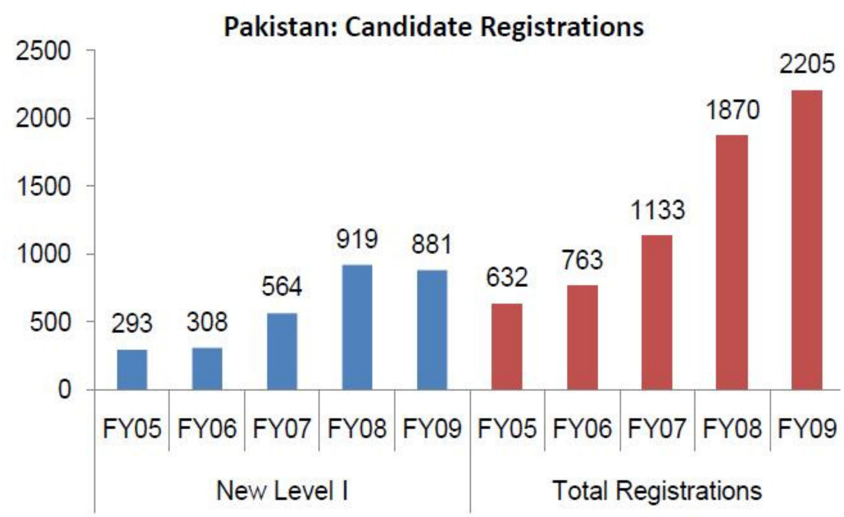
CFA Pakistan Statistic 2009

Member Trends

Numbers as of 1 July for each year

	2004	2005	2006	2007	2008	2009
Total Members	71	77	91	114	121	127
Annual Growth Rate		8%	18%	25%	6%	5%

Candidate Trends



	New Level I				
	FY05	FY06	FY07	FY08	FY09
Candidate Registrations	293	308	564	919	881
Annual Growth Rate		5%	83%	63%	-4%

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GIPS Seminar

CFAAP arranged a seminar on GIPS on 31st August, 2009 at Marriot hotel in Pakistan. Aim of the seminar on GIPS was to increase the awareness of standard performance measures, which are lacking in our capital markets. Mr. Louis Boulanger, CFA, member of GIPS Executive Committee explained GIPS and its applicability requirement in detail. He highlighted the benefits of GIPS for the investment community and progress GIPS has made in term of number of countries who have already adopted GIPS.

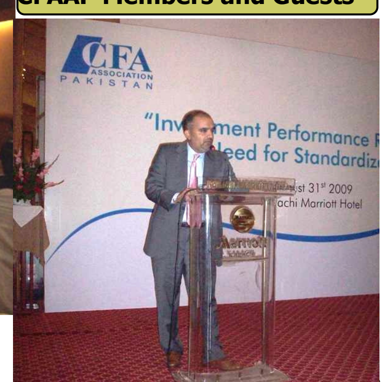
Mr. Louis talked about various questionable practices of performance and how GIPS helps in overcoming these practices. Mr. Louis stated that main aim of GIPS is to increase the confidence of investment community in the integrity of performance presentation and data reflected in performance. He also said that applicability of GIPS in any market will foster the transparency and ethical standards. He stated that CFA Institute is striving to take the application of GIPS on the global level.

Chair for the Pakistan GIPS committee Mr. Mir Muhammad Ali, CFA who is also the Chief Executive Officer of UBL Funds was present on the occasion. He highlighted the progress made on GIPS standard in Pakistan

Louis Boulanger, CFA

CFAAP Members and Guests

CFAAP Members and Guests



Mir Muhammad Ali, CFA

Upcoming Events

Charter Award Ceremony 2009 & Networking Event—December '09

The Annual Charter Awards Ceremony is scheduled to be held in first week of December 2009. The event is held each year to recognize the achievements of those individuals who have successfully met the academic and professional requirements of the CFA Program. The Charter is earned after a candidate has passed three levels of examination, and completed the minimum four-year work experience requirement.

The following individuals have successfully met all academic and work experience requirements mandated for new CFA Charterholders. We extend our congratulations and look forward to seeing them receiving their Charters in December 2009

A networking session is also planned which will give an opportunity to new charterholders to interact with senior charterholders & members of CFA Association of Pakistan.

Global Investment Research Challenge- January 2010

CFA Pakistan has decided to participate for the 2nd time in Global Investment Research Challenge (GIRC). We started the process of recruiting a team of motivated and bright students from universities across Pakistan. There are 7 teams comprising of 4-5 students who are participating from local universities and finalists will be chosen to represent the country at the Regional level.

CFA INSTITUTE | GLOBAL INVESTMENT RESEARCH CHALLENGE

LUMS, IBA, SZABIST, CBM, Bahria, Muhammad Ali Jinnah University and NUST have given their consent to participate in the event. The local event is planned to take place in January 2010.
CFA Institute, USA will provide full financial assistance for the traveling related expenses to the students for international trip (regional and global). It will also give the students an opportunity to find a career path in renowned organizations both locally and internationally.

The Global Investment Research Challenge (GIRC) organized by CFA Institute USA gives students from the worlds top business schools the opportunity to learn from industry experts and compete with their peers. The challenge teaches participants best practices in equity research through hands-on mentoring and intensive training in company analysis and presentation skills.

University teams of 3-5 students are mentored by industry professionals in writing an equity research report on a publicly traded company at the local level. The teams then present their findings to a panel of experts, first at the local and then at the regional level. The winning local team would then proceed to the regional competition. The company we have selected on which the students will write their research report is United Bank Limited (UBL).

CFA Career Day - January 2010

Career Day has become an important annual event of CFA societies worldwide. The purpose of the Career Day is to spread awareness of the CFA Program and its benefits in career development. It is a full day open-house event offered to all university students. CFAAP is organizing a Career Day in January 2010. A newspaper advertisement and invitations to all universities and the relevant faculty advisors will soon be sent off.

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Pakistan's Economy:
Export diversification – key to sustainable growth

In November 2008, Pakistan entered the IMF program in order to beef up the country's fast depleting foreign exchange reserves and avert an imminent balance of payment crisis. While Pakistan's macroeconomic indicators have improved markedly over the past 12 months, much of the recently achieved macroeconomic stability is 'borrowed'. Our structural macroeconomic problems remain persistent, and require the policy makers to prepare a well though-out strategy to overcome them.

Principal amongst structural economic issues is lack of diversification in exports. According to the Asian Development Bank (ADB), Pakistan's economic growth faces a balance of payment constraint; that is, the country runs into external account problems following periods of relatively high growth (above 5%). This is largely because the country's exports have low sophistication and low world income elasticity of demand, leaving the balance of payments vulnerable to the vagaries of global commodity markets. In its *Asian Development Outlook 2009* (April 2009), the ADB graphed an index of export sophistication of selected Asian economies, which reflected the degree to which a country's export basket was similar to that of industrial economies. Pakistan ranked at the bottom. This is due to the fact that our export basket comprises mainly of traditional textiles which fall in the lower end of the textile range. In order to relax the balance of payment constraint and achieve sustainable high growth, it is of chief importance that exports grow out of their present state of low sophistication and strategy development to achieve this goal should be amongst the top priorities of the policy makers.

Toward this end, Pakistan and ADB have recently launched the Pilot Dialogue for Structural Transformation (PDST), which is a mechanism to engage public and private sector in dialogue at the product level in order to diversify country's exports and to increase their level of sophistication. Ten products have been initially chosen which include, among other items, gems and jewellery, meat and preparations, non-metallic mineral manufactures, dairy products, oils and perfume materials, and medicinal and pharmaceutical products.

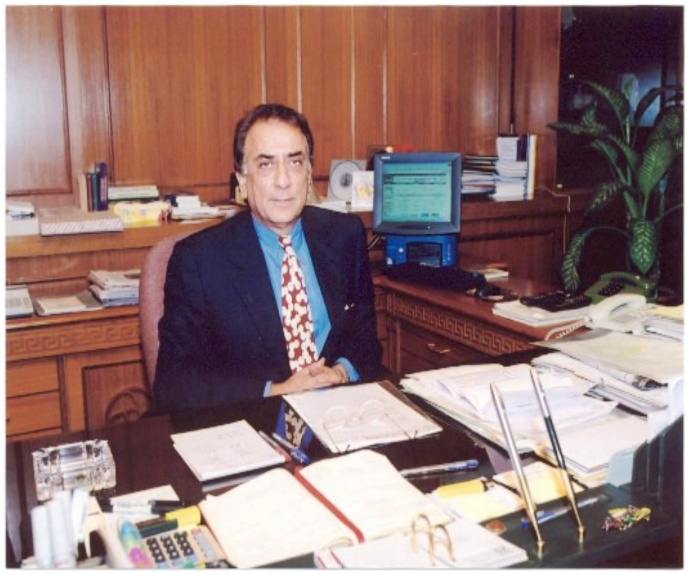
Besides diversification in products, new export markets also need to be tapped. Like other emerging economies, Pakistan is heavily dependent on two markets for its exports – United States and European Union – which together account for about 45% of our total exports. With these key consumer regions experiencing recession, exports are likely to remain subdued in the near term.

Export diversification strategy would naturally require overcoming power and water shortages, up-gradation of the manufacturing sector, increasing productive capacity and improving technology. Understandably, supporting policies in other spheres would need to be developed and followed. Principal amongst these is fiscal policy. While it is critical to keep fiscal deficit within limits agreed under the IMF program, it is also important to realize that reducing fiscal deficit via cuts in development spending on human and physical infrastructure limits long-term growth potential. More desirable measures are also being taken to overcome fiscal slippages, such as the shift from price subsidies toward income subsidies targeted to the poor households, and introduction of value added tax (VAT) regime by July 2010 to improve the tax/GDP ratio.

Though the current stand-by arrangement with the IMF would come to end in December 2010, Pakistan is likely to remain in the IMF's fold under successor programs for a long time. While this may be considered undesirable from certain aspects, it would provide the much needed policy discipline to ensure that the country does not run into another balance of payment crisis. External financing is likely to remain available given our strategic importance in the war against terror. Moreover, global commodity prices have provided respite. Pakistan must effectively utilize this window of opportunity in order to address its lingering structural macroeconomic issues.

Raza Khan Niazi - Head of Research
Raza started his professional career with Invisor in January 2006 as sell-side equity research analyst. He was promoted to Head of Research in March 2009. During his stay at Invisor, Raza has covered Economy, Banking, Fertilizer, and Chemical sectors. Raza passed CFA Level 3 exam in 2008, and holds an MBA (Finance) from Institute of Business Administration, Karachi.

Executive Interview: Mr. Ali Raza, President, National Bank of Pakistan



CFAAP :What are your views on the economy? Interest rates in Pakistan are one of the highest in the region, what are your views on the interest rates in future?

We were in a very different situation in September and October of last year; this had nothing to do with the international crisis. It was what we should call a perfect storm. Many things happened at the same time. For instance, KIBOR went up, call rates touched the sky, money market was out of liquidity and equity markets fell dramatically. In the 2008 budget there was a huge fiscal drag that Government was carrying because of subsidies. Reserves were depleting at an enormous pace falling to $4.5 billion in a short interval. To add to that there was a kind of mini run on the banks for multiple reasons. And we are all aware about what happened to the Mutual Fund Industry, which faced massive redemptions on account of heightened uncertainty and apprehensions.

Government last year took a very bold step by going to IMF as there was no other way through which Pakistan could have raised its reserves and stabilized our currency. Since capital markets collapsed there was no way Pakistan could have issued a foreign currency bond. Due to crisis internationally many investment banks went down, you know what happened to Merrill Lynch. In my opinion IMF program is not a harmful program because it forces austerity and it forces transparency and it forces fiscal space, which Government doesn't necessarily like. Governments are always populists and they want to show to people that they are doing great things.

The results since last year to date has been extremely encouraging, reserves have gone from $ 4.5 billion to $ 14.5 billion, stock market is up by approximately 50%, currency has been relatively stable even though there has been a slight deterioration but certainly not equal to what happened in Sept 08 and Oct 08 when it went over Rs.60 to almost Rs.90 against dollar. So reserves are stable and so is the currency. GDP growth obviously has been 2.5% but if you look at it in relative terms, there are over a 100 countries that have witnessed a negative growth last year and only about a handful of countries which have seen growth in excess of 2%. So 2.5% growth is not bad at all considering all the issues our economy has faced.

This year the challenges are even greater than what they were before. This is mainly because we are now a war-driven country and have a huge additional expense on this war on terror. The expenditure on this war is estimated to be around Rs.200 billion. And then there are other costs to these suicide bombings. People for instance are not coming to Pakistan, insurance rates have hit the sky and so on and so forth. Energy is another major problem that we are facing. A lot of Industries are suffering because of gas shortage and load shedding with common man sharing the burden of latter. So the monetary and non monetary costs of war are having a severe detrimental effect on our economy.

This year's targeted growth of 2.5% will largely come out of agriculture because the industry is expected to witness a negative growth and agriculture is expected to show a positive growth. Government has taken certain bold steps like increasing the Gas and Petroleum prices. It was not a populist move but they have done it. They have taken the bullet and will have to do more of that because they don't have any other option.

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So I think economic management has been very strong. Under current circumstances and despite all our problems the fact that we are still managing a positive growth is a huge achievement in itself.

CFAAP: Pakistan is relying on foreign help through loans i.e. IMF program, which we have to start paying back in near future; in your views are there any other ways to raise dollar and increase the reserves?

At the moment what are the sources to raise the foreign currency of our country:

- Privatization
- Exports
- Remittances
- Foreign Direct investment

Now you look at all these one by one. Privatization is obviously going to be out of the window. If you look at Foreign Investment numbers of 2005, 2006 and 2007, 60% of that was coming in the shape of current transfers which is not happening now. So that option is out looking at current law and order situation of our country. In the FDI, $1.5 to $2 billion comes through companies which are already in the Pakistan to keep their operations going and for expansions. But new investment obviously, given the circumstances, can't be expected except some investment in the Power sector. Since oil prices have touched $75 to $80/barrel again we might see some investment in Oil and Gas sector as well. But I don't think you should expect too much FDI in the current environment because of high interest rates, energy shortages and terrorist attacks.

So then you come to exports and I think exports will do well. They are down by only 10% but I think with the new textile policy and some of the efforts that Government is making on market access in US and Europe, there probably will be a pick in exports next year. Some non-traditional exports are doing very well. Rice exports for example were over $2 billion last year, and we saw increase in the exports of non-traditional items of over 100% to 150%. So exports are going to be relatively stable.

Remittances on the other hand are going up and that is because of number of reasons. Government and SBP have now in place a proper setup through which they are focusing on Non-Resident Pakistanis (NRPs) making it very convenient for overseas Pakistanis to send their funds here. They have also launched a crack down on money changers for their involvement in illegal foreign currency transfer out of Pakistan thereby encouraging Foreign Currency to come in country through legal channels.

We also have Kerry Lugar Bill and commitments from Friends of Pakistan. I think these will certainly assist the economy. Kerry Lugar bill will almost entirely be spent on social infrastructure particularly on areas which are hit by recent war on terrorism.

Friend of Pakistan is an excellent initiative. We are talking about over $13 billion to $16 billion, $ 7.5 from Kerry Lugar Bill and rest from Friends of Pakistan and other sources in next five to six years. So when the money comes in it will definitely increase our overall Foreign Currency reserves and will help stabilize Rupee. However, we have to make sure that our trade deficit remains within the manageable limits because you don't want money going out to be greater then money coming in, which will again deplete the reserves. But in the next 3 to 5 years Pakistan will do much better than over the last couple of years. Agriculture has huge potential domestically as well as huge export potential; we can increase yields and make our agriculture sector much more efficient by expanding credit to this sector. Similarly in 3 to 5 years we will be able to solve energy problems sufficiently, and see increase in the industry capacity utilization to above 70%, which presently is at around 20% to 30%. All this will help in increasing the industrial productivity, tax revenues and exports.

Pakistan's strategic location has a downside now but it can become huge potential going ahead; it's a corridor of energy of Central Asia and Emerging Economies. Realizing this fact Chinese Government secured its access through Gwadar Port. So we have a strategic location and we are a critical country for this whole region. I also see Indo-Pak relations improving and more trade will take place between the two, which will bode well for both the countries. May be Pakistan will be a bigger beneficiary of this in comparison to India. When two countries trade the smaller country benefits more than the larger one because the smaller country gets access to a bigger market.

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Going forward, I see economic situation stabilizing because of all these factors I have talked about. I see growth rate of 4% to 6% by 2011 to 2013. I also see military insurgence being successful in the northern areas. Once this war on terror ends, it will create burst of economic activity all over the country. Once this happens it will open the doors of economic activity for Pakistan because many companies will expand their operations there and create a lot of employment opportunities. I am very optimistic about medium term. In longer-term I am hugely optimistic. We will solve the energy crisis and trade will increase. Our GDP is 1% of SAARC Countries. It has potential to go up to 7 to 8%, which is the minimum of what it should be.

CFAAP: How is banking sector going to fare in new environment of high inflation, low growth? NPL numbers of the banking industry are continuously increasing. Do you see this trend continue in the near future?

Yes, the NPLS have grown and it has more to do with energy crisis and law and order situation in the country. If interest rates go up by a couple of percentage points, companies find various means of reducing that impact by achieving efficiency, by stretching the payables and brining in cost controls but if they don't have the energy they cannot operate. If you cannot operate, you cannot sell and if you cannot sell, you obviously cannot service your debt. So a lot of our problems arise from energy crisis, basically. As you go forward in the years 70% to 80% NPLs can come back in the balance sheet of the banks and will add to their net income. Because when a loan becomes a loss, we have to take 100% provisions for the loan. And if the company is restructured or is sold we can reverse some percentage of the provisions made. Since we have been very aggressively creating cash provisions in the reserves it hurts our current income but it creates the cushion of revenues for future profitability, that is, if you can collect the loan. If there is a loan of Rs. 100 and I take 100% provision against the loan, now let's suppose that 3 years down the road I collect Rs. 70 of the loan, it will be my incremental income. So the collection of NPLs over the next 5 years will be good source of the revenues for the banks, because we have already provided for those loans. So the income statement receives the benefit when the proceeds are realized.

It is difficult time for the banking industry. The banking sector is going through some challenges. Small banks have difficulties due to their inability to meet the minimum capital requirements as capital was eroded from recent loan losses. We will see quite a few mergers and acquisitions. May be 2 or 3 years down the road we will see 18 to 19 banks out of 40 banks operating today as small banks will find it much more practical either to sell to a larger institution or merge with other smaller banks.

CFAAP: What's National Bank strategy looking at current economic scenario as growth in credit to corporate sector is negative? We have also seen that in past National Bank has concentrated on corporate lending, it does not offer products like car financing or credit cards; are there any plans to launch consumer financing in future?

Growth of loans to private sector has been negative because the demand of the loans has gone down. Factories are operating at low capacity and won't take the loan due to low demand of products. So the demand has to increase. Because of interest rates being relatively high, banks are finding other ways of raising the capital outside the banking system. But the total loans in the system are growing largely because the Government borrowing through the banking sector is increasing. The circular debt, for example, has largely been settled through banking system. So over all credit is same or growing but the private sector is less active than the public sector. That will continue until the next budget.

Consumer banking at the movement is the last thing to focus on due to high risk associated with credit to this sector and high NPLs in the consumer sector.

During the recent crisis, the largest hit sector, in terms of the loan losses, was consumer sector. The banks, which were focusing on the consumer sector have to take a huge hit on their books due to defaults in the consumer sector. So that is certainly a no-go area for National Bank of Pakistan. Our focus is going to be on the Agriculture Financing, SME and Project Financing, structuring and catering to Capital Markets, industrial projects like IPPs, Coal Projects and oil terminals. A lot of fund is required there and banks are going to focus their energies there.

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CFAAP: Mutual fund investment as percentage of GDP is low, there is room for growth in future; Do you see them as a threat to banking industry?

Mutual Fund industry is surviving due to tax arbitrage incentive because for an individual there is no tax and for the companies they don't pay corporate tax and pay much less. So as long as arbitrage is there the mutual fund industry will continue to grow but it may take few months for this industry to pick up after recent crisis. NAVs have gone down by 40% and many companies have gone under. But I have confidence in the Mutual Fund Industry. It is good industry to invest in for the people who don't have time or expertise to invest in stock or fixed income market.

CFAAP: Any message for CFAAP? How do you think we can contribute in Pakistan's capital Markets?

One of the biggest tragedies in financial sector of Pakistan is that we don't have a developed capital market. Companies rely on Banks to meet their borrowing needs. In the mature economy companies have multiple sources of raising capital. There are Corporate Bonds, Commercial Papers, sophisticated banking sector products, IPOs, Private Equity, and others depending on company's line of business. When you talk about cost of capital in the developed economies, you are talking about weighted average cost of all these mentioned sources. I think one of the major roles you can play is by sending message to companies to start tapping the capital markets and not entirely depend on banking sector. Very few companies wants to tap the capital markets and the major reason is that because they are family controlled and the level of disclosure is quite limited and consequence of that is they cannot achieve the rating they want. So your message should be to encourage transparency in financial reporting and send message to companies to professionalize so that they start attracting the people of your quality. How many MBAs, CAs and CFAs are attracted to work for a private company? So you can create awareness for the companies about how important it is for them to professionalize and diversify sources of raising capital and take advantages of opportunities within the country. So that is the message I want to give to your organization and its members. I keep on saying this to our clients and on forums where I speak. A lot of companies that I know and deal with have grown 3 to 4 times in last few years but their number of MBAs, CAs, CFAs and other professionals is still what it was years ago, which is not sustainable and healthy.

Interview by:

Ms. Rukhsana Narejo, CFA
Rukhsana is presently a Director of CFA Association of Pakistan. Ms. Rukhsana, is banking & finance professional with 9+ years of exceptional track record in leading highly successful strategic marketing, business development and relationship management initiatives having specific proficiency in fixed income fund management, financial analysis as well as product development.

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CFA Association of Pakistan

Contact Us :

Corporate & Investment Banking Group
Allied Bank Limited
2nd Floor, Khayaban-e-Iqbal
Main Clifton Road, Bath Island
Karachi

Phone: 021-35868498
Fax: 021-35301050
Email: info@pakistan.cfasociety.org

Visit our Website : www.membersocieties.org/pakistan
www.cfainstitute.org

Rukhsana Narejo, CFA
Director
CFA Association of Pakistan

Uroosa Girami
Executive Director
CFA Association of Pakistan

CFA PAKISTAN NEWSLETTER TEAM

Kamran Aziz
Fund Manager,
ABL Asset Management Ltd.

Abdul Rasheed Narejo, CFA
Head of Capital Market
Allied Bank Limited