A. The National Economy

1. **Macroeconomic trends.** After experiencing economic growth with a compound annual growth rate (CAGR) of 5.1% during 2001–2007, Pakistan witnessed much weaker growth of 3.8% CAGR during 2008–2015 that was characterized by a challenging investment climate, political instability, weak (but recently improving) fiscal discipline, weak public sector governance, and an unresolved energy crisis. Despite a modern banking system, Pakistan's financial intermediation is low and deteriorating compared to its regional peers. The ratio of domestic credit to the private sector to gross domestic product (GDP) stood at only 15% of GDP in 2015, declining from 28% in 2007. The massive surge of public sector borrowing undermines private access to affordable credit. Financial inclusion remains very low and access to credit is worsening, with only 3% of the adult population having loan accounts and 30% having deposit accounts.\(^1\) Poverty remains widespread with official estimates indicating a poverty headcount ratio of 44% in Pakistan and 46% of the urban population living in slums.

2. **Structure.** The economy is driven by a resilient services sector, representing 56% of GDP, characterized by a CAGR of 5.6% during 2001–2007 and a still-robust 4.6% during 2007–2015. Industrial output represents only 19.0% of GDP and is characterized by weakening growth because of issues with power supply and connectivity, with a CAGR of 7.2% during 2001–2007 and a very weak 3.1% during 2007–2015. The share of agriculture remained stable at 26% of GDP in 2000 and 25% in 2015. The weaker but stable growth of 2.9% CAGR during 2001–2007 and 2.8% during 2007–2015 reflects the resilience of the agriculture sector and points to the large potential for efficiency and income gains for farmers to move from subsistence to market-oriented production. Remittances also became a significant income source. The following table summarizes the key characteristics of Pakistan’s economy.

<table>
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<tr>
<th>Pakistan Economy Characteristics</th>
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<td>GDP growth (annual %)</td>
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<td>Agriculture (% of GDP)</td>
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<td>Industry (% of GDP)</td>
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<td>Services (% of GDP)</td>
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<td>Remittances received (% of GDP)</td>
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<td>Consumer price index (2010 = 100)</td>
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</tbody>
</table>


CAGR: Compound annual growth rate.

3. Pakistan’s business climate is hampered by political instability, corruption, and low private access to bank finance. A comparison of South Asian countries conducted by the World Economic Forum\(^2\) confirms that Pakistan’s economic environment is inferior to its regional peers. This is because of its high political and policy instability, poor infrastructure (especially the unstable power supply), corruption, and inefficient government.

4. Pakistan draws particular strength from the resilience of its informal economy, including subsistence farming. Since 2000, Pakistan’s population has grown by 35 million to 179 million in 2012. The urban population in large cities has grown at a CAGR of 3.0%, while the urban population in cities of less than 1 million grew at a CAGR of 2.2%.

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B. The Sindh Economy

5. Sindh has a population of 44 million, and in 2015 an estimated 17 million people lived in Karachi. The GDP of Karachi is estimated to represent 25% of the national GDP.

6. With limited own sources of revenue,\(^3\) federal transfers constituted 79% of Sindh’s budget in 2016.\(^4\) In addition, the Government of Sindh (GOS) lacks the creditworthiness needed to raise debt from the market. Only PRs225 billion (or 25% of Sindh’s annual budget) was allocated to the Annual Development Plan in FY2017, which funds infrastructure development among other initiatives (footnote 4). The World Bank estimates that Sindh’s annual infrastructure investments only represent 3%–4% of estimated requirements in transport, electricity, water supply and sanitation, solid waste, telecommunication, and irrigation.\(^5\) In addition, Sindh requires investments in health and education.

7. Sindh’s unemployment rate was 4.2% during 2013–2014 (3.6% for men and 7.4% for women), and the labor force participation rate was only 30.5%.\(^6\) GDP growth averaged 4% during FY2012–FY2016, which is 3% less than the estimated growth required for full labor force absorption.\(^7\)

C. Finance Sector and Infrastructure Financing

8. Pakistan’s finance sector consists of 41 banks, which held PRs14.1 trillion\(^8\) of finance sector assets in 2015. The asset base of nonbank financial institutions is relatively small, at PRs78 billion. Other major players in the finance sector include the National Savings Scheme (with a portfolio of PRs3.1 trillion), mutual funds (with net assets of PRs443 billion), insurance companies (with total premiums of PRs192 billion), and microfinance institutions (with loans of PRs93 billion). While the State Bank of Pakistan regulates banks, development finance institutions, and microfinance institutions, the Securities and Exchange Commission of Pakistan is the regulator for insurance companies, other nonbank financial institutions, and private pension funds. The Pakistan Mercantile Exchange is the country’s futures commodity exchange. With the merger of the exchanges in Karachi, Lahore, and Islamabad in January 2016 into the Pakistan Stock Exchange, there is a single exchange in Pakistan. The Pakistan Stock Exchange has carried positive momentum, and was announced to be included in the emerging market index (reclassified from frontier market) by MSCI in June 2016.\(^9\) There were eight new

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\(^3\) Revenues to provincial and local governments include agricultural income tax, property taxes, service sales tax, and royalties on crude oil and natural gas. However, in the absence of dedicated bodies for collection, such revenues are minimal.


\(^5\) L. Andres, D. Biller, and M. Dappe. 2013. Reducing Poverty by Closing South Asia’s Infrastructure Gap. Washington, DC: World Bank. pp. 12–13, Tables 5 and 6. The study estimates Pakistan’s infrastructure investment requirements for 2011–2020 in six key sectors to range from $116.0 billion to $165.0 billion, or $11.6 billion to $16.5 billion per year. Given that Sindh’s population and GDP represent 23% of the country’s total, the annual requirements for Sindh may be $3 billion–$4 billion equivalent.


\(^9\) MSCI Emerging Markets Index is an index created by Morgan Stanley Capital International (MSCI) designed to measure equity market performance in global emerging markets.
equity listings and two new debt instruments listed in 2015. The corporate bond market is very small and slowly developing.

9. Banks are very liquid with stable retail deposit funding that is reinforced by incoming overseas remittances. Total banking deposits stood at PRs10.4 trillion at the end of 2015. However, banks traditionally provide limited benefits to the economy as funding of the federal budget deficit through the purchase of government securities and loans absorbs a large part of the banks’ funding, as reflected by the extremely low loan–deposit ratio, which averaged 48% in 2013–2015.

10. Currently, banks are the major funders for commercial infrastructure financing. However, funding from banks has only moderately increased, from PRs276 billion in 2009 to PRs444 billion in 2015. Because of well-established legal and regulatory frameworks and standard power purchase agreements, commercial financing in 2015 was concentrated in power (62%), followed by telecommunications (16%), petroleum, and roads (footnote 9).

11. Financing of infrastructure projects through the capital market is not developed. Infrastructure financing is far below its potential because of (i) significant risks in that the execution of agreements is undermined by the prevailing unresolved circular debt in the energy sector; (ii) the traditional approach of banks, with a preference for asset-backed corporate loans rather than cash-flow-based project financing; and (iii) significant construction risks and uncertainty about the ability of projects to generate sufficient revenues to service the debt. To help address this gap, the State Bank of Pakistan (i) issued guidelines on infrastructure project financing, and (ii) developed the structure for a special-purpose vehicle for infrastructure financing to enable the issuing of long-term bonds as well as Shariah-compliant sukuk bonds in the local market. However, such structures have not fully penetrated the long-term financing market, and there have been very limited infrastructure bond issuances and placements in the past.

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11 Circular debt represents the cash flow shortfall incurred by the Central Power Purchasing Agency, which limits its ability to service its debt to power suppliers, representing a high credit risk for commercial financiers.


13 Sukuk is an Islamic financial certificate, similar to a bond in conventional finance that complies with Sharia or Islamic religious law.