

Pakistan's promises to IMF in doubt as protests sap economy

REUTERS, Islamabad

Anti-government protests that have gripped Islamabad since mid-August could throw off course economic reforms Pakistan promised to deliver in return for an IMF bailout, senior officials said, raising the risk of a sovereign rating downgrade.

The International Monetary Fund (IMF) saved Pakistan from possible default last September by agreeing to lend \$6.6 billion over three years, conditional on reforms such as a longstanding pledge to privatise loss-making state companies.

There is no suggestion that the assistance, which is disbursed in tranches, is about to dry up.

"The programme is not in jeopardy at the moment," said a top economic adviser with direct knowledge of talks with the Fund. "The IMF folk think that if we can wrap this crisis up in a week or so, things will remain on course and normal. But if it goes on any longer, then, yes, we will be in trouble."

Commerce Minister Khuram Dastgir Khan voiced concern that an IMF team had already cancelled a visit to Pakistan because of the protests that turned violent last week as Prime Minister Nawaz Sharif refused to resign. He said more than a year of efforts to fix the economy had "gone up in smoke".

"The government has very painstakingly been building a house of international confidence, and the foundation of this was the IMF package and abiding by our reforms' promises," the minister told Reuters. "But... our struggles of 14 months have gone up in smoke in a matter of 14 days. We are pushed to a point where we have to go back to the drawing board."

For now, credit ratings agency Standard & Poor's is watching



REUTERS

Anti-government protesters pull a rope to remove a container barricade during the Revolution March in Islamabad yesterday. Pakistani protesters pushed closer to the prime minister's house in central Islamabad on Monday in their bid to force his removal.

events unfold in Islamabad, where followers of cleric Tahir ul-Qadri and cricket star-turned-politician Imran Khan camped out for two weeks before advancing on government buildings.

S&P currently has a B- sovereign rating for Pakistan, which was thrown the IMF lifeline to bring down inflation, reduce its fiscal deficit and tackle a crippling energy crisis.

Robert Zhong, Hong Kong-based sovereign analyst at S&P, said structural reform may largely continue despite the political turmoil, but added: "If there are signs these programmes will be dislocated, we could review the rating."

At Moody's, Singapore-based

sovereign analyst Anushka Shah echoed that view, saying the "political developments would have implications for Pakistan's creditworthiness if they resulted in a derailment of the structural reform process".

Investors have taken fright over the agitation against Sharif, who won a decisive victory in May 2013 elections, the first democratic transition in Pakistan's turbulent history.

Since Imran Khan announced on Aug. 5 that his supporters would besiege the capital, the benchmark 100-share Karachi Stock Exchange index has fallen more than 7 percent, but recovered some of that on Tuesday, and the rupee has lost 3.4 percent against the dollar.

Two foreign heads of govern-

ment have cancelled visits to Pakistan due to the protests, and Sharif himself has called off a trip to Turkey. The worry now is that they could ruin a visit this month by President Xi Jinping of China.

"These people should realise they have disrupted the journey to progress," Sharif said at the weekend. "We want to set up many energy plants and electricity projects in Pakistan in partnership with Chinese corporations. That may also be disrupted."

Commerce Minister Khan said the bidding process for an energy park of 10 coal power plants with a total capacity of 6,600 MW has been postponed because investors are unwilling to commit to the country

in the current political climate.

"This is a government that has been trying to improve investor confidence," he said. "But if the government's fate itself is under question, then of course this confidence will be affected."

Meanwhile, development spending in poverty-stricken areas of the country has been throttled by the turmoil because employees of executing agencies are not turning up for work.

According to a senior official at the Planning Commission, 70 billion rupees (\$690 million) was earmarked for development spending in July-August, but just 40 percent of that was spent.

"People are living in abject poverty... without education and health and roads and water, but Imran Khan wants power at the centre," the official said. "These protests have totally botched up our priorities."

Normal life and business in Islamabad have been thrown into disarray as the protests grind on.

Honda Centre is one of Pakistan's largest car dealerships. The freshly painted showroom is state of the art, with high ceilings, well-dressed staff and a collection of art prints on the wall. But it's barely seen any customers for weeks.

"Logistics aren't running, we can't get the cars that we've booked, customers aren't leaving their homes to pick up their cars and clients aren't coming in to get their cars fixed," said Hassan Raza, the dealership owner. "I've lost 90 percent of my business."

"And this is across the economy. People are going out to buy essential stuff, food items - but they're not buying cars, or clothes. They're not going to the cinema. If this continues, the economy is dead. The impact has already been huge."

Amid foreign crises, Obama takes solace in US economic turnaround

REUTERS, Milwaukee

Throughout much of his presidency, Barack Obama has been under siege about the state of the US economy.

But with economic growth now far more robust than when he took office, he is finding some measure of solace on the domestic front while a number of crises rage abroad.

With his handling of foreign policy under fire in confronting challenges from Ukraine to the Middle East, Obama made a Labor Day trek to Milwaukee's annual Laborfest event to underscore how he feels his leadership on the economy has paid off. "I just want everybody to understand because you wouldn't always know it from watching the news," he said. "By almost every measure, the American economy and American workers are better off than when I took office."

The national unemployment rate was 6.2 percent in August, down more than a percentage point from the year before, and a far cry from when he took office in 2009 with the economy in crisis. After a 2.1 percent contraction in GDP in the first quarter of this year, GDP rebounded at a 4.2 percent growth clip in the second quarter.

Still, the job market for many is unsatisfactory and some have given up looking for jobs. Also many of the proposals Obama has made to create more jobs, such as persuading Congress to accept an increase in the minimum wage and boost infrastructure spending, have gone nowhere, forcing him to act where he can with executive orders.

Obama took credit, however, for the improving economic picture by harking back to decisions he made early in his first term, when he led an effort to bail out the U.S. auto industry. He also said his signature healthcare law has made life better for American workers: "America is stronger because of decisions we made to rescue our economy and rebuild it on a new foundation asking the simple question: is this good for ordinary Americans?"

With little more than two months to go until November mid-term elections, the president was greeted at the airport by Wisconsin Governor Scott Walker, a potential Republican candidate to succeed Obama in 2016. But Mary Burke, the Democratic challenger to Walker in Wisconsin's governor's race, steered clear of the Laborfest event, saying it was an official event, not a political one.

Obama made no specific reference to the state's governor's race, but he continued a pattern of criticising Republicans at official events, blasting them for refusing to go along with his agenda in Congress and telling members of the audience who booed: "Don't boo. Vote!"



SQUARE

Samuel S Chowdhury, chairman of Square Group, attends the re-launch of Square Consumer Goods as Square Food and Beverage at a programme, at Square Centre in Mohakhali, Dhaka recently. Anjan Chowdhury, managing director of Square Food & Beverage, was also present.

100 days of Modi: Good for business, not so good for marginalised groups

In his first 100 days, Prime Minister Narendra Modi has protected the food security of millions of Indians on the global arena, but early trends suggest his government's pro-business policy will hurt the environment and the poor.

In "100 days review of NDA government" - a report released on Tuesday, focusing on issues faced by the country's poor and marginalised - civil society groups delivered a mixed verdict on Modi's coalition National Democratic Alliance (NDA) government, which swept to power in May.

Compiled by Wada Na Todo Abhiyan (WNTA), a coalition of more than 4,000 civil society groups, the report examines early trends and emerging policies in governance, environment, health, education and the rights of women and marginalised groups.

"There are several reasons to be optimistic such as India's robust position regarding food security on the global stage, a mission mode attempt to end financial exclusion, plethora of schemes announced for women," it said.

Last month, Modi's government vetoed the adoption of a World Trade Organisation (WTO) treaty to streamline rules for shipping goods across borders.

The deal was blocked as the government wanted more attention paid to WTO limits on stockpiling food which it feared would impact its subsidised food distribution programme that aims to feed nearly 850 million people.

The WNTA - which includes charities such as World Vision, Jagori, Water Aid India and India Alliance for Child Rights - praised commitments to stem the rising

reports of violence against women with efforts such as the establishment of 660 One Stop Crisis Centres for rape victims.

The NGOs also lauded Modi for a decision to make 50 essential generic medicines free of cost, commitments to build toilets in every home, and the better functioning of parliament. One of the most worrisome trends in Modi's first 100 days was a policy to expedite environmental clearances for industrial projects.

"The environment minister has declared that the environment ministry is no more the 'roadblock ministry', but one where decisions are being taken faster," the report said.

"The civil society is concerned that haste or efficiency could be at the expense of justice and the well being of the environment, natural resources and community."

It said within a month of assuming power, the NDA's rural development minister hinted at diluting the amount of say local communities have in the exploitation of their natural resources.

Expansion of coal mines has been exempted from public hearings, and mid-sized polluting industries can now operate within 5 km of national parks and sanctuaries, as opposed to 10 km as indicated in a Supreme Court directive, it said.

The charities also said they were "unsettled" following the leak by the NDA of an Intelligence Bureau report that criticises organisations such as Greenpeace India, ActionAid India and Oxfam as being anti-development and funded by foreigners with interests against India.

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Basel III deposit challenge looms over Islamic banks

REUTERS

As banks around the world gear up to meet tough Basel III regulatory standards, Islamic lenders face a source of uncertainty that could prove expensive for them: how regulators will treat their deposits.

In most ways, Islamic banks look well-placed to cope with Basel III, which will be phased in across the globe over the next few years. Most of the banks are from the Gulf and southeast Asia, where economies are strong.

Since Islamic finance frowns on monetary speculation, their balance sheets are largely clear of the derivatives and complex, risky assets that sunk some of their conventional peers during the global financial crisis. They should therefore have little trouble in meeting Basel III's minimum capital standards.

But their deposit bases could become a headache. Because interest payments are not allowed by sharia principles, Islamic banks obtain deposits mostly through profit-sharing investment accounts (PSIAs), which are generally considered to be more volatile than conventional deposits.

Islamic banks are expected to be required to offset that volatility under Basel III by increasing the amount of high-quality liquid assets (HQLAs) which they hold.

But Islamic securities markets are much younger, shallower and less developed than conventional markets, so sharia-compliant HQLAs are in short supply - squeezing Islamic banks on two fronts.

"These are two of the more important challenges that Basel III is introducing to the Islamic finance industry," said Paris-based Mohamed Damak, primary credit analyst at credit rating agency Standard & Poor's.

Islamic commercial banks held about \$1.2 trillion worth of assets at the end of last year, according to a study by Thomson Reuters. They account for roughly a quarter of deposits in Gulf Arab countries and over a fifth in Malaysia.

Basel III requires banks to hold enough HQLAs to cover net cash outflows for a 30-day period under a high-stress scenario. Outflows are calculated by applying different weights to funding sources, including PSIAs. The riskier the funding source, the larger the amount of HQLAs needed to cover it.

So a lot will depend on the weights or "run-off rates" which national regulators around the world, who will implement Basel III in their own jurisdictions, choose to assign to PSIAs.

Regulators have yet to give an indication of the likely weights. They are keen to develop their Islamic banking sectors, so they are unlikely to assign punitive weights. But they may not be able to treat PSIAs as benignly as conventional bank deposits. For instance, PSIAs held by Islamic banks tend to have relatively short maturities, according to an S&P report.

The treatment of PSIAs will also depend on factors specific to the Islamic banking industry in each country, such as how it behaved in past stress situations, and the track record of Islamic



REUTERS/FILE

A customer visits the Bank Islam branch office in outside Kuala Lumpur on November 6, 2013.

banks in passing losses on to deposit holders under their contracts, Damak said.

The uncertainty looks unlikely to be cleared up at least until early next year, when the Malaysia-based Islamic Financial Services Board (IFSB), a global standard-setting body, is expected to release a guidance note on the subject.

"Ultimately it is the regulator in each country that will decide what will be the treatment of PSIAs, and here the IFSB guidance note will be of significant value to help regulators decide how to treat PSIAs," Damak said.

The note will deal with issues such as the contractual rights of depositors, for example whether they can withdraw money in fewer than 30 days without a significant penalty, said a source familiar with the IFSB's deliberations.

Malaysia's central bank has issued some guidance on PSIAs, saying it will classify them as two types: general PSIAs, broadly equivalent to conventional retail deposits, and specific or restricted PSIAs, deemed similar to managed investment accounts. It has given Islamic banks a two-year transition period to differentiate between those types.

But while the central bank has already spelled out ratios and weights for Basel III capital adequacy rules, it has not yet announced run-off rates or HQLA requirements for PSIAs. Commercial bankers think these might be revealed early next year, after the IFSB guidance.

Basel III says national regulators around the world could assign run-off rates of 3 percent or higher to stable, conventional bank deposits, and as much as 10 percent to less stable deposits, according to S&P.

Most Islamic banks may end up being assigned numbers within that range; given the size of the deposits at stake, a variation of several percentage points could make a big difference to how much HQLAs the banks are forced to hold.

The PSIA issue may increase pressure on central banks and governments around the Islamic world to address some longstanding problems in Islamic finance. One is the small supply of HQLAs. With the exception of Malaysia and Bahrain, few central banks actively issue instruments which qualify as HQLAs, Damak said.

Government-issued sukuk qualify, but most sovereign sukuk are either not listed on developed markets or are not actively traded, making it very hard for Islamic banks to obtain them. This contrasts with conventional banks' access to huge markets in high-quality government debt such as U.S. Treasuries and German Bunds.

Alternatives such as the short-term sukuk issued by the Malaysia-based International Islamic Liquidity Management Corp, which was established to promote a cross-border market in Islamic instruments, remain small compared with the overall size of the industry, Damak noted.

As part of its efforts to develop an Islamic financial centre, Dubai is actively trying to list sukuk on its exchanges and encouraging its state-linked firms to issue tradeable sukuk, but it may be years before supply begins to meet demand.

Another problem is deposit insurance. For bank deposits to be deemed stable they need to be protected by an insurance scheme, but sharia-compliant schemes are rare, partly because government support for domestic banks is considered implicit in many Gulf countries.