

A good legacy

Ishrat Husain finished his second term as governor of the State Bank of Pakistan in December with a sense of accomplishment: the country's stagnant banking system has been turned into a healthy industry catering to the needs of the middle class and SMEs. He talks to Adrian Murdoch.

One of president Pervez Musharraf's first appointees, Ishrat Husain took over the governorship of the State Bank of Pakistan in December 1999. At the time, the economy was a mess. Growth was stagnant, banks were bloated and clinging on in the public sector. Indeed, the financial sector as a whole was mired in corruption. Self-interest was the order of the day.

President Musharraf's faith in the former chief economist of the World Bank's East Asia and Pacific region has been justified. As one Karachi paper suggested, Husain has, in many ways, been south Asia's answer to former US Federal Reserve chairman Alan Greenspan, changing policies to suit changing economic situation, but without deviating from market orthodoxy. There is no doubt that he has been the linchpin in the economy's revival ever since, overseeing massive inflows of foreign capital as the economy recovered, which has led to unprecedented foreign exchange reserves and a stable rupee.

At the same time, Husain has led Pakistan's war on terror from a financial point of view, clamping down on money laundering and terrorism by encouraging banks to know their customers better. Here too he has been successful in creating an environment where potential customers who have suspect paperwork are turned away.

At the end of his second term of office and in one of his last interviews as governor, Husain explains to Global Agenda how Pakistan is now moving to a new level of economic maturity and muses on his time in office.

GLOBAL: The high international price of oil in recent months has had a negative effect on inflation. Does this cause concern?

ISHRAT HUSAIN: Inflation is now coming down, and we hope that it will decline further as oil prices drop. After all, the price of a barrel of oil is now \$57 compared to \$60. You must also remember that it is now the middle of winter. Oil prices will continue to decline as we enter spring, which will have a positive impact on inflationary expectations. On top of that, we have a tight monetary policy which is already having the desired effect. Private sector credit was down in the first four months of this fiscal year, and broad money supply is declining – both of which are continuing to dampen inflation.

GA: Your new capital adequacy regulations for banks call for a phased increase to PKR6 billion (\$100 million) by 2009. What do you expect the effects to be?

SHEIKH: Twenty banks in Pakistan carry out 95% of all business in the country. There are a further 18 banks, which carry out only 5% of business. These banks have no particular advantage in this market. They don't have any network, products, technology, scale or human skills. Their contribution is insignificant. The idea behind the regulations is that Pakistan should have 20 stronger and well-networked banks that can service a broad spectrum of our population.

GA: If these 18 banks have little to offer, what is the point of mergers?

SHEIKH: You are getting whatever branches you have. You are adding to your network.

GA: Prime minister Shaukat Aziz has spoken of the need for second-generation reforms in the banking sector. What do you understand by that?

SHEIKH: We need to deepen our capital markets because the big corporate houses should not rely on banking finance for their long-term capital needs. They should go to the equity markets, have IPOs, enter the bond market and even go to foreign markets to raise debt and equity.

GA: Last year saw a five-fold increase in corporate debt instruments – 12 worth approximately PKR15.5 billion in 2005. Is that something you welcome?

SHEIKH: From my perspective, it is still very little, because we want to deepen the market. We want to do more. We want to ensure that the resources of the banking sector are available for Pakistan's middle-income groups, for small and medium enterprises, and for small farmers. When the benefits of the banking industry are widely distributed, that will give rise to sustainable and equitable growth. The more purchasing power you put in the hands of the majority of the population, the better the distribution of the benefits of growth.

GA: Has the landscape for SMEs improved?

SHEIKH: Last year, 17% of entire bank credit was channelled towards this sector, and it is increasing every year. We have completely

