

February 01, 2010

**Pakistan Market****SBP 3QFY10 Policy statement–status quo maintained** KSE100 Index: Closing 9614.19 ↑ (+34.38)**MORNING BRIEFING**

In its policy statement released over the weekend, the SBP opted to keep rates intact due to the consideration for the tight liquidity conditions prevailing in the system. Interestingly, SBP projects money growth of 14.5% for the full-year, however, it expects delays in external disbursements and the high commodity financing overhang from last year which would complicate the upcoming wheat crop financing and strain the bank's abilities to lend. The SBP recognized, uncertainty regarding the external inflows as the most prominent risk to macro economic stability which can deeply affect the twin deficits. Importantly, SBP indicated that its reserves have increased to US\$10.6bn as on 27th January 2010 and are projected to be around US\$15bn by the end of FY10. The massive rise of US\$4.4bn (Rs374bn) in reserves is itself highlighting the liquidity easing in 2HFY10, in our view. Lastly, the SBP emphasized on either increasing the resource envelope or for the government to learn to live within the resources available to avoid crisis.

**So what needs to be corrected?**

- Fiscal discipline, led by contained expenditures.
- Retirement of last year commodity financing.
- Resolution of the inter-corporate debt.
- Release of foreign flows.
- Price pass-through to avoid future resource loss.

**Fiscal discipline:** If we adjust the security expenditures (one-off due to the security operation) the discipline is evident. To meet the deficit targets, the GoP has already announced cutting development expenditure by Rs150bn or 1% of GDP. On the revenue front, SBP itself pointed out the managed moderation of aggregate demand in the system, which will not bode well for revenue collection unless a stimulus is provided.

**Commodity financing:** The substantial storage of wheat by the government and retaining over Rs316bn of commodity financing clearly indicates in the government's policy flaw of

keeping higher support prices. Either the government should dispose off its stocks in the domestic market or export it, otherwise there is a greater risk of resource loss.

**Inter-corporate debt:** The latest increase in electricity prices should rein in the inter-corporate debt in the months to follow.

**Foreign flows:** We believe the gap arising as a result of delay in foreign flows should be bridged through external borrowing or other bilateral sources, rather waiting and keeping the system at risk. The CSF and Kerry-Lugar are sure to eventually to flow in, as Pakistan has incurred security cost on the guarantee of USA.

**Price pass through:** The depreciation of the exchange rate by over 3.7% in 1HFY10 and the electricity price adjustment itself are proof that the automatic price transmission exists in the system.

**SBP's closing remarks and over views**

SBP concluded its policy as *"it can be stated with confidence that much has been gained on the macroeconomic stability front despite a very challenging economic and security environment. A lot of difficult decisions and adjustments have been introduced to tackle a host of structural constraints. However, much work remains to be done to consolidate this stability and set the stage for sustainable recovery. After carefully evaluating improvements in numerous macroeconomic variables and sifting through their underlying dynamics and associated uncertainties, SBP has decided to keep the policy rate unchanged at 12.5%"*.

**Our view:** We opine, SBP has transferred oil payments to the market and the government has almost done away with the subsidies mechanism. This will keep an automatic check on aggregate demand even if the commodity prices spike. The one-off security expenses, inefficient commodity financing and delay in the inter-corporate debt could not be resolved with keeping rates higher. Swift efforts at the government level would be required to restore the macroeconomic

balance in favour of growth stimuli. Hence, we believe it is high time for interest rates be adjusted on the downside.

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**Also in focus****Local oil prices revised up by 4.8–9.4%**

Local petroleum products' prices have been raised by OGRA in the range of 4.8%-9.4%. Higher Arab Gulf petrol and diesel prices during January 2010 have been the primary reason behind the hike. It is likely to have a positive impact of Rs1.3-1.4 per share for PSO; including a possible pre-tax inventory gain of Rs350mn. However, with decline in international petroleum prices recently, though early days, local oil prices may be revised down for the month of March, which in turn would offset the current positive impact on the company. With PSO trading at a FY10E PE of 6.6x, we maintain our 'Buy' stance on the scrip.

**Table: Local Petroleum prices**

(Rs per litre)	New	Old	Δ%
MS	71.21	65.11	9.4%
HOBC	86.84	79.43	9.3%
HSD	71.86	68.56	4.8%
JP-4	52.15	49.61	5.1%
SKO	64.06	60.75	5.4%
LDO	61.07	58.10	5.1%

Source: Ogra & PSO

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