

September 15, 2009

Pakistan Market**Monetary Policy 2QFY10 expectations****MORNING BRIEFING**

KSE100 Index: Closing 9075.26 ↑ (+16.49)

We believe, liquidity conditions remained tight in the last one month despite rate easing by SBP in August. KIBOR is up 47bps, T-bill yields 30bps and bond yields 50bps. The interest rate corridor introduced by SBP has so far fetched the desirable results and helped stabilize the rupee exchange parity despite the transfer of diesel payments to market in August.

As we highlighted earlier, without quantitative easing, rate easing cycle will render ineffective. This can be highlighted from SBP's last one month OMOs, where it opted to inject seven times with the total quantum of PRs258bn. In the forthcoming policy release, we expect SBP to revisit existing rate of CRR and opt to reduce it by 1ppt to 4ppt. Every 1ppt cut in CRR roughly adds Rs30bn to liquidity. We expect no change in the policy rate in the September 29, 2009 review.

200bps rate cut expectation intact

Our view on monetary easing by another 200bps remains intact, but we expect rate easing in November and January policy statements, primarily on account of better inflation, contained twin deficit and subdued money and credit growth. Additionally, fund flows from IFIs and the expected disbursements from Friends of Pakistan will render more confidence to SBP on reduced government appetite for budgetary borrowing.

Data snap shot

Inflation: FBS reported CPI inflation at 10.7% in August, down from 11.2% in July. However, monthly inflation rose to 1.7%- third consecutive month with an increase of over 1%. This is worrisome and likely to restrain SBP to ease aggressively. On the positive side, underlying (core) inflation has reduced to 12.6% in August from 14.0% in July. The NFNE has increased by meager 0.8ppt month-over-month. Our full year forecast for inflation stands at 9-10%.

C/A deficit: Though the C/A deficit statistics for August have yet not been released but on the basis of trade deficit of US\$1bn and record remittances of US\$780mn, we expect

C/A deficit to be around US\$800mn. Similarly, the disbursement of US\$1.2bn by IMF has strengthened overall reserve position of country to over US\$14bn.

Monetary aggregate: Squeezed trade deficit and higher dollar inflows led by remittances and IFIs flow has changed the composition of monetary aggregate. As per SBP, NFA surged to Rs102bn during July-August 2009, compared to net outflow of Rs115bn in the corresponding period last year. Moreover, NDA depicted a contraction of Rs184bn compared to Rs19bn expansion witnessed in corresponding period last year. Both NDA and NFA are painting a favorable balance of risk situation of the country. This can be highlighted from net retirement of Public Sector Enterprises loans of Rs11bn compared to disbursement of Rs27bn last year.

SBPs' injections since August 15, 2009

Date	Amount Accepted (Rs mn)
15-Aug-09	31,600
17-Aug-09	13,000
18-Aug-09	45,000
22-Aug-09	39,550
25-Aug-09	16,575
29-Aug-09	22,000
1-Sep-09	16,550
5-Sep-09	37,500
12-Sep-09	36,850
Total amount injected	258,625

Source: JS Money Market

Interest rate corridor a brief review

SBP has successfully launched an interest rate corridor in the last policy statement through introducing an 'overnight repo facility' that should act as a binding 'floor'. Since August 15th, market has utilized the repo and reverse repo option on three occasions. In between SBP injected Rs258bn on seven occasions. We expect SBP to maintain the existing spread of 300bps in the next policy while it may opt to reduce CRR rate by 1ppt.

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Also in focus**Cotton prod. expected to fall 12% short of target**

According to an official of Ministry of Food and Agriculture, Pakistan is expecting a shortfall of 12% in cotton crop estimates due to recent Cotton Leaf Curl Virus. The estimated cotton production for the season is expected to be around 11.7mn bales as against the target of 13.9mn bales and 10.8mn bales production last season. We believe the cotton prices are likely to increase in the wake of this shortcoming. Currently, cotton prices are hovering around Rs3,500-3,600 per maund versus Rs4,000 per maund last season and may affect margins for the textile units.

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