JS Research

May 22, 2009

Pakistan Market

MORNING BRIEFING

Are Pakistani Banks well-placed to extend funds?

KSE100 Index: Closing 6969.82 ↓ (-90.90)

Is there sufficient liquidity available to banks to fund private sector and government? A billion-dollar question maneuvers in treasurer and fund managers mind. We believe this is too important to address, as the 'V-shape' recovery can't be possible without sufficient liquidity in the system. Moreover, we believe, liquidity will continue to drive the interest rate path. Hence the significance of policy rate is irrelevant for now.

Looking forward, we expect another Rs200bn liquidity to be injected in the system, which should compensate the dwindling deposit base of commercial banks. This should also ease the pressure on KIBOR, which is expected to average around 11% in FY10, compared to existing 13.5%.

SBP view on liquidity and credit growth

Let's see what SBP thinks *"the sharp fall in private sector credit during FY09 is a combination of both reduced demand and a reluctance of scheduled banks to extend credit. On the other hand, scheduled banks' ability to lend became limited due to low deposit generation and heightened risk due to rising NPL's"*.

And why banks' ability to lend became limited, *due to "contracting, though improving, NFA and slower expansion in NDA have constrained money supply growth".*

JS view on liquidity

OMOs: Since April 1st, SBP injected money nine out of total eleven times it conducted Open Market Operations (OMOs). Cumulative injection for the period was recorded at Rs412bn, with an average injection of Rs50bn for 5-days. This highlights tight liquidity situation prevailed in the market.

Monetary aggregate: As per SBP, money growth reached 4.59% during July to May 9th, against 8.96% recorded for corresponding period last year. NFA contracted by Rs227bn compared to contraction of Rs290bn last year, while, NDA expansion highlights significant slowdown to Rs442bn compared to Rs655bn year earlier. Interestingly, the M2 growth is depicting a rising trend on commodity finance up-pick and government borrowing off late.

JS outlook: We expect full-year budget deficit to be at 4.3% of GDP compared to 3.1% deficit recorded in 9MFY09. Meaning, another Rs160bn would be needed to finance the deficit. Given the government SBP borrowing at Rs170bn to date, another Rs88bn can be borrowed directly from SBP to reach the IMF imposed Rs258bn target. Additionally, we expect US$1.5bn would be added through external flows in the next 40 days. This should capitalize the banks by another Rs200bn, hence putting downward pressure on KIBOR and help M2 growth to reach 9% by June end.

Table: Monetary Aggregate trend (Rs bn)

	Stocks as of Jun 2008	1st Jul to 9-May-09	1st Jul to 10-May-08
CIC	982	200	186
DTL	3,703	14	181
Broad Money (M2)	**4,689**	**215**	**364**
Growth		***4.59%***	***8.96%***
NFA	**668**	**(227)**	**(291)**
NDA	**4,022**	**442**	**655**
Net GoP Borrowings	1,510	458	421
Budgetary support	1,365	340	360
From SBP	1,034	184	551
From Scheduled Banks	331	155	(191)
Commodity Operations	127	120	61
Credit to Private Sector	2,888	22	370
Credit to PSEs	137	138	44

Source: SBP

Interest rate outlook and investment perspective

On the back of our 300bp DR cut expectation and reflationary environment, we prefer bonds over T- bill. In reflation cycle bonds out-performed cash and utilities. An equity market tends to bottom out in reflation and cyclical stocks usually out-performed defensive plays. We recommend investors to keep the track on quality cyclical plays like DGKC, ENGRO, NML etc.

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Also in focus

Oil price cut- OMCs & refineries margins intact

Yesterday the government reduced domestic oil prices by 2.5% (Rs1.45-1.8 per liter) on various oil products, lower than the expectation of 6-10%. Analyzing the oil pricing sheet, the reduction was made through PDL, a revenue item for the government. Moreover, no changes have been made in OMCs and refinery margins.

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