

July 23, 2010

## Pakistan Market

## MP outlook: Provinces dominating the scene

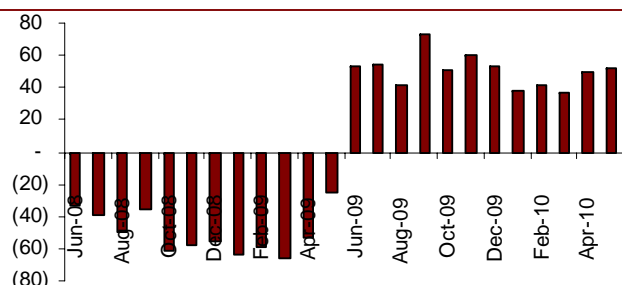
MORNING BRIEFING



KSE100 Index: Closing 10228.86 ↓ (-5.17)

After a relative austerity at the Federal level this time around, provinces took the front seat and preferred expansion over the discipline, burdening the national kitty by a hefty Rs65bn deficit vs the government's estimate of Rs77bn surplus. As a result, we now expect the deficit to rise to 6.0% as against the government's initial estimate of 5.1% for FY10. The key question arises as to how the Central Bank will interpret this indiscipline in its upcoming policy review for 1QFY11. Market participants are expecting a gap between money demand & supply and hence re-pricing of the debt by at least 50bps. This can also be verified from July 21 PIB auction bid pattern, where participation witnessed an increase of 65bps compared to the last cut-offs. Interestingly, the Ministry of Finance has not entertained this demand and has opted to scrap the tender. We believe, market expectations are primarily driven from the auction calendars, where the SBP has indicated pre-auction targets of Rs85bn and Rs535bn for PIB and T-bills respectively as against the expected inflows of Rs465bn.

## Net claims on provincial government (Rs bn)



Source: SBP

Though macro data has depicted an improvement in Current Account deficit, contained inflation, and a weak credit growth, we believe it would be very difficult to justify an increase in policy rate purely on the ground of provincial indiscipline. Hence, we expect the SBP to maintain its status quo in the upcoming monetary policy review on July 30.

## Macro and monetary data snapshot

**Current Account deficit:** The deficit for FY10 improved to US\$3.5bn compared to US\$9.2bn reported in FY09, predominantly driven by contained balance of goods, services & income deficit and higher current transfers.

**Inflation:** FY10 CPI arrived at 11.73%, down from 20.77% in FY09. Interestingly, inflationary pressures have eased off in the last few months of FY10 as evident from May and June MoM statistic of 0.06% and 0.65% respectively. The underlying inflation (ex-food & energy) was also reported at 10.4% in June, compared to 15.9% year ago. As majority of the pass-through is already being done, we expect inflation to gradually move to single digit terrain in 2HFY11. In our view, inflation is to be in the range of 9-10% for FY11.

**Fiscal deficit:** While 4QFY10 fiscal deficit data is still awaited, we expect deficit to surge to 6.0% compared to an earlier estimate of 5.1% on the back of provincial fiscal indiscipline. As a result of a consensus reached on the 7th NFC awards, provinces are likely to take on a larger chunk from the federal revenue pool from FY11 & onwards. We believe fiscal discipline from provincial side is imperative to attain next year's fiscal deficit target of 4.0% of GDP.

## Pakistan: Provincial Fiscal Operations, 2009-10

	July-Sept. 2009	July-Dec 2009	July-Mar 2009-10
Total Revenue	173,156	385,471	604,456
Provincial share in Fed revenue	132,147	284,790	439,083
Provincial Taxes	11,249	23,655	35,414
Provincial Nontax	10,026	21,368	38,560
Federal Loans and grants	19,734	55,657	91,399
Total expenditure	183,221	366,074	566,316
Current Expenditure	143,788	293,174	449,141
Development Expenditure (PSDP)	39,433	72,900	117,175
Overall Balance	(10,065)	19,397	38,140

Source: Ministry of Finance

**Monetary growth:** Broad money growth surged to 12.46% in FY10, compared to 9.56% in FY09. Higher money growth was

primarily driven by improved external position. Moreover, the private sector credit growth remained weak and came in at Rs112bn vs. deposit growth of Rs494bn.

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## Also in focus

## Forex Reserves increase to US\$16.70bn

The foreign exchange reserves of Pakistan have increased by US\$75mn to US\$16.70bn for the week ending on July 16, 2010 as compared to US\$16.63bn the week before. Reserves held by the SBP also rose to US\$12.87bn along with those held by the commercial banks that came at US\$3.84bn.

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