

June 24, 2010

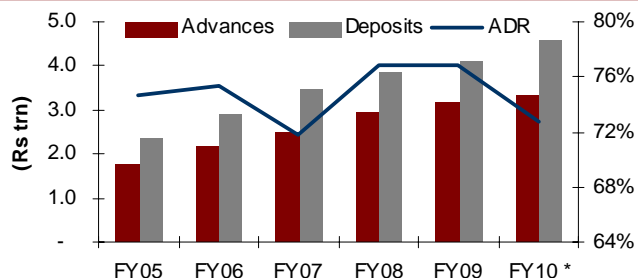
**Pakistan Market****Deposits, credit, and spreads update****MORNING BRIEFING**

KSE100 Index: Closing 9715.39 ↑ (+33.07)

After a single digit deposit growth of 7.5% in FY09, deposits have surged by 12.9%YoY and 11.03%YTD during FY10 (Jul 1-Jun 18). Even this robust deposit growth combined with weak private credit off-take has failed to bring down market interest rates. We believe, this is due to a huge build-up in commodity financing coupled with higher deficit financing by the government. Importantly, funds stuck up in commodity financing last year has damaged the credit-cycle and kept short-term rates high and in turn the yield curve flat like. This has enabled banks to maintain last year's spreads against our expectations of the same declining. Going forward, we do not expect any ease in liquidity unless the government off loads its wheat stock through export and retire the much prolonged circular debt.

**Deposits rise by 12.9%YoY to Rs4.6trn**

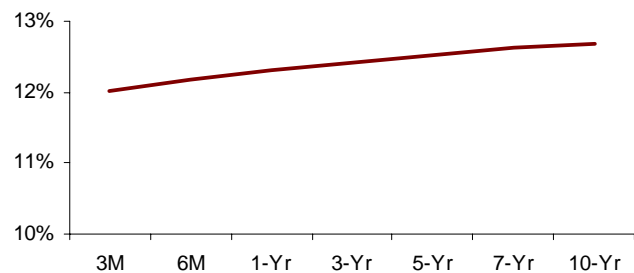
Interestingly, the deposit growth has picked up in 11MFY10 and recorded a growth of 12.9%YoY (to Rs4.6trn). The higher deposit growth is primarily driven by expansion in the NFA, led by funds credited to the Coalition Support Fund (CSF), Kerry-Lugar, FoDP & contained trade deficit; while govt. borrowing has kept NDA expansion going strong.

**Advances, Deposits & ADR trend**

Source: SBP, \* As of Jun 18, 2010

As the fiscal year end is around the corner, we expect overall deposit growth to further increase by 2-3% to close at 13% to 14%, inline with our M2 growth target. This will have a

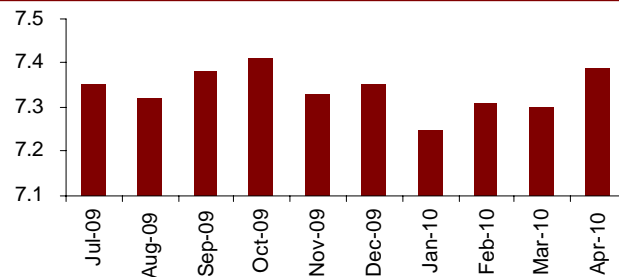
positive bearing on overall banking sector spreads.

**Yield curve**

Source: JS Money Market

**Credit growth down but investments up**

While credit offtake remained subdued and came in at 4.9%, compared to 7.7% last year, bulk of the deposits generated have been placed in T-bill investments and thus limited the credit available for private sector. All in all, Scheduled banks have invested Rs229bn in T-bills and Rs65bn in commodity financing in the first 350 days of the current fiscal year, compared to Rs159bn and Rs202bn respectively, in the corresponding period last year.

**Banking sector average spreads FY09 to date**

Source: SBP

**Key events to dictate liquidity**

We expect money growth to remain healthy on account of a

improving C/A deficit and foreign inflows from KLB, CSF and bilateral borrowing in FY11; while pressure of deficit financing is also likely to ease on account of reduced fiscal deficit expectation. The timely release of surplus wheat stocks and circular debt will play the key role to ease liquidity and in turn market rates. This should also reduce the banking sector spreads in our view. We anticipate the spreads to fall by 25 - 30bps from the current level by year end. Our preferred picks in the sector are UBL, MCB and NBP.

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**Also in focus****Pakistan to receive US\$800mn under KLB**

According to news reports, Secretary Finance Mr. Salman Siddiqui stated that Pakistan will receive US\$800mn under the Kerry Lugar Bill (KLB) by September 2010. Out of the total, US\$195mn would be for budgetary support which we believe is likely to help Pakistan meet its budget deficit target (expected at 4% for the next fiscal year). This should also help to further strengthen foreign reserves of the country which currently stand at US\$15.7bn.

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